TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1952

LIBRARY
SUPREME COURT, U.S.

No. 79

MARTHA L. ALISON

vs.

THE UNITED STATES OF AMERICA

ON CERTIFICATE FROM THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

FILED MAY 3, 1952
Order for entire record June 9, 1952

UPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1952

No. 79

MARTHA L. ALISON

vs.

THE UNITED STATES OF AMERICA

CERTIFICATE FROM THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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Appendix

In the United States District Court for the Western District of Pennsylvania

Civil Action No. 3974

Martha L. Alison

v.

United States of America

Docket Entries

Feb. 28, 1945—Complaint filed.

Feb. 28, 1945—Summons issued.

Mar. 7, 1945—Summons returned served with copy and complaint on George Mashank, Ass't U. S. Attorney for Charles F. Uhl, U. S. Attorney, 637 New Federal Bldg., Pgh., Pa. March 1, 1945 at 3:15 PM and on the Attorney General of the United States at Washington, D. C. by sending copy of complaint to him by registered mail March 1, 1945.

Apr. 27, 1950—Answer to Complaint filed.

Dec. 6, 1950—Subpoena returned executed by U. S. Marshal, served on Mrs. Frank W. Dean, 767 Lebanon Ave., Mt. Lebanon, Pa., personally on Dec. 4, 1950 at 5:20 P.M.

Dec. 11, 1950—Order entered assigning case to Judge Marsh for Trial.

Dec. 11, 1950—Stipulation of Facts filed by defendant.

[fol. 2] Dec. 11, 1950—Hearing on Non Jury Trial, before Marsh, J. begun.

Dec. 11, 1950—Hearing concluded C. A. V. Trial Memo filed.

Jan. 16, 1951—Order entered extending time for filing of the Government's brief to February 1, 1951.

May 17, 1951—Findings of Fact; Conclusions of Law; Order of Court entered directing judgment be and the same is hereby entered in favor of the defendant.

May 17, 1951—Pursuant to Order of Court entered Judgment is hereby entered in favor of the defendant. Stephen P. Laffey, Clerk.

May 18, 1951—Notices mailed.

July 12, 1951—Notice of Appeal filed by plaintiff.
July 12, 1951—Copies of Notice of Appeal mailed to Clerk U. S. Court of Appeals and to Counsel with letters.

IN UNITED STATES DISTRICT COURT

STIPULATION OF FACTS

In the above case the following facts are agreed to and submitted to the Court as part of the record.

I

The plaintiff brings this action against the United States pursuant to the provisions of Section 24 of the Judicial Code, as amended, U. S. C. A., Title 28, Section 41 (20), [fol. 3] the action arising under the Internal Revenue Laws of the United States.

II

On or about March 11, 1942, the plaintiff filed her income tax return for the calendar year 1941 wherein she reported a tax of $2,711.78, which was subsequently increased to $2,843.78. The amount of $2.843.78 was paid, $2,711.78 on March 11, 1942, and $132 on November 19, 1942.

III

On March 30, 1943, the plaintiff filed a claim for the refund of the amount of $2,843.78, plus interest, which is based upon a claimed deduction of $21,804.90.

IV

On or about August 28, 1943, the Treasury Department indicated to the plaintiff an intention to reject the claim in full; whereupon, the plaintiff filed with the Internal Revenue Agent in Charge, at Pittsburgh, Pennsylvania, on September 24, 1943, a written protest against the proposed rejection.

V

On May 2, 1944, the Commissioner of Internal Revenue formally notified the plaintiff that her claim for refund

was disallowed for the reason that the loss, which was claimed as a deduction for the year 1941, was an embezzlement attributable to the years 1931 to 1940 and did not occur in 1941.

VI

One J. W. Cree, prior to his death on November 24, 1941, was the manager of several trust estates and also a business agent and adviser for a large number of persons. Among his clients was the plaintiff in this case whose [fol. 4] maiden name was Martha Liggett. When the plaintiff was a minor Mr. Cree was her guardian and after she became of age, Mr. Cree continued as her business agent and adviser. The plaintiff's chief source of income was from real estate and securities and Mr. Cree had complete control and possession of the funds and property of the plaintiff. There was no written agreement between the plaintiff and Mr. Cree respecting funds and securities and no accounting was ever requested or given by Mr. Cree. The account of the plaintiff, as well as other trust accounts, was carried in a separate set of books called the "J. W. Cree, Jr., Trust Account", the funds of which were commingled with his personal funds. The securities were likewise carried in the name of J. W. Cree, Jr.

VII

Shortly after the death of Mr. Cree, the plaintiff found from an examination of his books and records that there was due her cash in the amount of $30,155.37, which sum was not available for the reason that Mr. Cree had commingled those funds with those of his own and had been using them for his personal benefit. The plaintiff was the largest creditor of Mr. Cree's estate and inasmuch as the estate did not have sufficient funds to pay all creditors, an agreement was reached whereby the plaintiff took a loss of $21,804.90 on her claim, which included a cash payment of $3,380.95 to the plaintiff by a creditor of Mr. Cree's estate. This cash payment was made to the plaintiff under date of November 18, 1942. After these transactions were completed, the plaintiff's loss arising out of the settlement amounted to $21,804.90.

[fol. 5]

VIII

Throughout the period from 1931 to the date of Mr. Cree's death on November 24, 1941, Mr. Cree was a director in several banks and prominent in real estate circles as well as in business circles in the City of Pittsburgh. He enjoyed substantial credit and had a reputation of meeting all his obligations as they accrued.

IX

The amounts taken by Mr. Cree and the amounts paid back to the plaintiff, as shown by Mr. Cree's books, are as follows:

Years	Amount Taken	Amount Paid Back	Net Amount Embezzled
1931	$ 8,000.00	$ 2,000.00	$ 6,000.00
1932	500.00	.....	500.00
1934	2,000.00	.....	2,000.00
1935	3,000.00	.....	3,000.00
1936	4,800.00	500.00	4,300.00
1937	2,000.00	.....	2,000.00
1938	4,950.00	1,450.00	3,500.00
1939	4,300.00	.....	4,300.00
1940	1,500.00	.....	1,500.00
1941	.....	.....	.....
	$31,050.00	$ 3,950.00	$27,100.00
Add: "Uninvested principal in principal (stock) Acc't			3,055.37
Total uninvested cash embezzled			$30,155.37

X

The plaintiff had no reason to suspect that any of her funds were being embezzled by Mr. Cree and had no knowledge of such embezzlement until after his death.

[fol. 6]

XI

Either party to this stipulation may offer further evidence not inconsistent with the facts herein stipulated.

Karl E. Weise, Hirsch & Weise, Attorneys for Plaintiff.

Edward C. Boyle, United States Attorney.

IN UNITED STATES DISTRICT COURT

OPINION

MARSH, District Judge:

This case came on for trial before the court without a jury, upon the pleadings and the written stipulation of the facts. Briefs have been filed and considered, and the court makes the following

Findings of Fact

1. The plaintiff brings this action against the United States pursuant to the provisions of Section 24 of the Judicial Code, as amended, U. S. C. A., Title 28, Section 41 (20), now 28 U. S. C. A. 1346 (a) (1), the action arising under the Internal Revenue Laws of the United States.

2. On or about March 11, 1942, the plaintiff filed her income tax return for the calendar year 1941 wherein she reported a tax of $2,711.78, which was subsequently increased to $2,843.78. The amount of $2,843.78 was paid, $2,711.78 on March 11, 1942, and $132.00 on November 19, 1942.

[fol. 7] 3. On March 30, 1943, the plaintiff filed a claim for the refund of the amount of $2,843.78, plus interest, which is based upon a claimed deduction of $21,804.90.

4. On May 2, 1944, the Commissioner of Internal Revenue disallowed the claim.

5. One, J. W. Cree, prior to his death on November 24, 1941, was the manager of several trust estates and also a business agent and adviser for a large number of persons. Among his clients was the plaintiff in this case, whose maiden name was Martha Liggett. When the plaintiff was a minor Mr. Cree was her guardian and after she became of age, Mr. Cree continued as her business agent and adviser. The plaintiff's chief source of income was from real estate and securities and Mr. Cree had complete control and possession of the funds and property of the plaintiff. There was no written agreement between the plaintiff and Mr. Cree respecting the funds and securities and no account was ever requested or given by Mr. Cree. The account of the plaintiff, as well as other trust accounts, was carried in a separate set of books called the "J. W. Cree,

Jr., Trust Account," the funds of which were commingled with his own personal funds. The securities were likewise carried in the name of J. W. Cree, Jr.

6. In 1941, shortly after the death of Mr. Cree, plaintiff discovered that he had embezzled from her the sum of $30,155.37. Certain sums were recovered by the plaintiff which left the net loss to her in the amount of $21,804.90, which she claimed as the deduction from her gross income as set forth in paragraph 3 above.

7. The net loss was established on November 18, 1942.

[fol. 8] 8. "The Net Amount Embezzled" for each year from 1931 to 1940, both inclusive, was determined from Cree's books.

9. No money was taken by Cree during the year 1941.

10. Plaintiff had no reason to suspect that any of her funds were being embezzled by Cree and had no knowledge of such embezzlement until after his death on November 24, 1941.

11. Throughout the period above mentioned, Cree was a director in several banks and prominent in real estate and business circles in the City of Pittsburgh. He enjoyed substantial credit and had a reputation of meeting all his obligations as they accrued.

From the foregoing Findings of Fact the court arrives at the following

Conclusions of Law

1. The plaintiff is not entitled to a deduction of any part of the loss of $21,804.90 in the taxable year 1941.

2. The defendant is entitled to judgment.

Discussion

The applicable provision of the Internal Revenue Code is Section 23 (e) 26 U. S. C. A.,[1] which provides: "In computing net income there shall be allowed as deductions: * * * (e) Losses by individuals. In the case of an in-

[fol. 9] dividual, losses sustained during the taxable year

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[1] Act of May 28, 1938, c. 289, § 23, 52 Stat. 460.

and not compensated for by insurance or otherwise—(1) if incurred in trade or business; or (2) if incurred in any transaction entered into for profit, though not connected with the trade or business; or (3) of property not connected with the trade or business, if the loss arises from fire, storms, shipwreck, or other casualty, or from theft."

In Boston Consol. Gas Co. v. Commissioner of Internal Revenue, 128 F. 2d 473 (C. A. 1, 1942), it was held that a loss sustained by the taxpayer through embezzlement in years prior to 1935 but no- discovered until that year could be deducted as a 1935 loss. The court gave considerable weight to the oppressive and unjust results to the taxpayer who was unable to establish the specific amounts embezzled in any particular year prior to the taxable year. In First Nat. Bank of Sharon, Pa. v. Heiner, 66 F. 2d 925 (C. A. 3, 1933) the Court of Appeals for the Third Circuit held that a loss sustained by the taxpayer through embezzlement prior to 1928 but not discovered until that year could not be deducted as a 1928 loss. The court refused to permit the taxpayer to convert a series of embezzlements in prior years into a bad debt, deductible in the taxable year. Factually these cases resemble the instant case except that here the embezzler was a trustee instead of an employee and the net amount embezzled in each year prior to 1941 was determined from the embezzler's books after his death.

If this were a case of first impression in this Circuit I would follow the conclusion reached in the Boston Consol. Gas Co. case, particularly for the reasons stated in Judge Magruder's concurring opinion.[2] Also, because I perceive [fol. 10] a connotation in the use of the word "sustained" in Section 23 (e) that losses by embezzlement are *sufferd* during the year of bona fide discovery although the property was covertly taken during previous years. It could then be concluded that Mrs. Alison did not sustain a loss until such time as she attempted, without success, to secure a return of her property.[3] However, since I cannot detect

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[2] This concurring opinion was mentioned in a footnote to *Commissioner v. Wilcox*, 327 U. S. 404, 406, which case establishes that embezzled funds do not constitute taxable income to the embezzler.

[3] See *Gwinn Bros. & Co. v. Commissioner*, 7 TC 320.

any fundamental distinction between the instant case and the Sharon case I am bound by the legal principles therein expressed. Judgment will be entered for defendant.

IN UNITED STATES DISTRICT COURT

ORDER

And now, this 17th day of May, 1941, after hearing and upon due and careful consideration, it is ordered that judgment be and the same is hereby entered in favor of the defendant.

(S.) Rabe F. Marsh, United States District Judge.

[fol. 11] IN UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

No. 10,538

[Title omitted]

Certificate to the Supreme Court of the United States

To the Honorable, The Chief Justice and the Associate Justices of the Supreme Court of the United States:

STATEMENT OF FACTS

In the above entitled case an appeal has been taken to this court by the plaintiff; Martha L. Alison, from a judgment of the United States District Court for the Western District of Pennsylvania entered on May 17, 1951 in favor of the defendant, the United States of America, in a civil action instituted under Title 28, United States Code, § 1346(a)(1), to recover the sum of $2,843.78 paid by the plaintiff for income taxes for the calendar year 1941.

From the pleadings and a stipulation of the parties as to the facts the district court made the following findings of fact:

[fol. 12] "1. The plaintiff brings this action against the United States pursuant to the provisions of Section

24 of the Judicial Code, as amended, U. S. C. A., Title 28, Section 41(20), now 28 U. S. C. A. 1346(a)(1), the action arising under the Internal Revenue Laws of the United States.

"2. On or about March 11, 1942, the plaintiff filed her income tax return for the calendar year 1941 wherein she reported a tax of $2,711.78, which was subsequently increased to $2,843.78. The amount of $2,843.78 was paid, $2,711.78 on March 11, 1942, and $132.00 on November 19, 1942.

"3. On March 30, 1943, the plaintiff filed a claim for the refund of the amount of $2,843.78, plus interest, which is based upon a claimed deduction of $21,804.90.

"4. On May 2, 1944, the Commissioner of Internal Revenue disallowed the claim.

"5. One, J. W. Cree, prior to his death on November 24, 1941, was the manager of several trust estates and also a business agent and adviser for a large number of persons. Among his clients was the plaintiff in this case whose maiden name was Martha Liggett. When the plaintiff was a minor Mr. Cree was her guardian and after she became of age, Mr. Cree continued as her business agent and adviser. The plaintiff's chief source of income was from real estate and securities and Mr. Cree had complete control and possession of the funds and property of the plaintiff. There was no written agreement between the plaintiff and Mr. Cree respecting the funds and securities and no accounting was ever requested or given by Mr. Cree. The account of the plaintiff, as well as other trust accounts, was carried in a separate set of books called the 'J. W. Cree, Jr. Trust Account,' the funds of which were commingled with his own personal funds. The securities were likewise carried in the name of J. W. Cree, Jr.

"6. In 1941, shortly after the death of Mr. Cree, plaintiff discovered that he had embezzled from her the sum of $30,155.37. Certain sums were recovered by the plaintiff which left the net loss to her in the amount of $21,804.90, which she claimed as the deduction from her gross income as set forth in paragraph 3 above.

[fol. 13] "7. The net loss was established on November 18, 1942.

"8. 'The Net Amount Embezzled' for each year from 1931 to 1940, both inclusive, was determined from Cree's books.

"9. No money was taken by Cree during the year 1941.

"10. Plaintiff had no reason to suspect that any of her funds were being embezzled by Cree and had no knowledge of such embezzlement until after his death on November 24, 1941.

"11. Throughout the period above mentioned, Cree was a director in several banks and prominent in real estate and business circles in the City of Pittsburgh. He enjoyed substantial credit and had a reputation of meeting all his obligations as they accrued."

The district court filed an opinion, which is reported in 97 F. Supp. 959, and reached the following conclusions of law:

"1. The plaintiff is not entitled to a deduction of any part of the loss of $21,804.90 in the taxable year 1941.

"2. The defendant is entitled to judgment."

Thereupon the district court entered the following judgment:

"And now, this 17th day of May, 1951, after hearing and upon due and careful consideration, it is ordered that judgment be and the same is hereby entered in favor of the defendant.

Rabe F. Marsh, United States District Judge."

The present appeal to this court was then taken by the plaintiff. The appeal was heard by three judges of this [fol. 14] court on February 20, 1952. Thereafter a rehearing before the court in banc was ordered by a majority of the circuit judges and was held on April 21, 1952, before six judges of the court.

The six judges of the court who sat in the rehearing of this case being equally divided in opinion as to whether the plaintiff's loss of $21,804.90 by embezzlement was de-

ductible in computing her taxable net income for the year 1941 in which the loss was discovered, the court hereby certifies the following question of law concerning which it desires instruction for the proper decision of the case, to wit:

QUESTION PRESENTED

When a taxpayer has suffered embezzlements over a period of years prior to 1941 and exact years in which each act of embezzlement took place are subsequently ascertained, are the net losses resulting from such embezzlements deductible by the taxpayer under Section 23 of the Internal Revenue Code in computing her taxable net income for the year 1941, in which year the embezzlements were discovered?

John Biggs, Jr., Chief Judge; Albert B. Maris, Circuit Judge; Herbert F. Goodrich, Circuit Judge; Gerald McLaughlin, Circuit Judge; H. E. Kalodner, Circuit Judge; William H. Hastie, Circuit Judge.

[fol. 15] Clerk's Certificate to foregoing transcript omitted in printing.

[fol. 16] SUPREME COURT OF THE UNITED STATES, OCTOBER TERM, 1951

No. 792

MARTHA L. ALISON,

vs.

THE UNITED STATES OF AMERICA

ORDER TO SEND UP ENTIRE RECORD—June 9, 1952

Pursuant to the provisions of section 1254 (3) of Title 28 of the United States Code and par. 2 of Rule 37 of the Rules of this Court it is ordered that the entire record in this case be sent up so that the Court may decide the entire matter in controversy.

LIBRARY
SUPREME COURT, U.S.

TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1952

No. 80

THE UNITED STATES OF AMERICA

vs.

STEVENSON-CHISLETT, INC.

ON CERTIFICATE FROM THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

FILED MAY 29, 1952

ORDER FOR ENTIRE RECORD JUNE 9, 1952

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1952

No. 80

THE UNITED STATES OF AMERICA

vs.

STEVENSON-CHISLETT, INC.

ON CERTIFICATE FROM THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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APPENDIX

IN THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF PENNSYLVANIA

No. 8117 Civil Action

STEVENSON-CHISLETT, INC.

v.

THE UNITED STATES

DOCKET ENTRIES

1949

Sept 21. Complaint filed.

Sept. 21. Summons issued.

Sept. 26. Summons returned served with copy of complaint on Edward Boyle, 1st Assistant U. S. Attorney for U. S. Attorney at Room 637 New Federal Bldg., Pgh., Pa. Sept. 21, 1949 at 3:20 P.M., EDST.; and by registered mail on the Attorney General of the United States Sept. 21, 1949, registered receipt and return receipt attached thereto.

Nov. 18. Stipulation filed and Order entered extending time for filing Answer to January 20, 1950.

1950

Jan. 18. Stipulation filed and Order entered extending time for filing answer to March 21, 1950.

Mar. 21. Stipulation filed and Order entered extending time for filing Answer to April 20, 1950.

April 19. Answer of Defendant filed.

1951

March 6. Subpoenas returned served on R. H. Maguire for W. T. Royston Co., and for W. S. Bonestell and W. T. Royston, at 908 Farmers' Bank Bldg., Pgh., Pa., March 6, 1951.

Mar. 7. Subpoena returned served on Mrs. William Seeds, for Mrs. Jean McKinney, at 5501 Center Ave., Pgh., Pa., on March 6, 1951, at 6:00 P.M.

Mar. 7. Subpoena returned served on Mrs. Bertha Wimmer, personally, at 1708 Trinity St., Pgh., Pa. on Mar. 6, 1951, at 3:15 P.M.

Mar. 8. Non-Jury Trial opens before Clary, J.

Mar. 8. Non-Jury Trial concluded C.A.V., Trial Memo filed.

Mar. 22. Transcript of proceedings hearing on Trial held March 8, 1951, at Pittsburgh, Pa., before Clary, J., filed.

April 20. Defendant's requests for findings of fact and conclusions of law filed.

Apr. 20. Plaintiff's requests for findings of facts and conclusions of law filed.

June 28. Findings of Fact and Conclusions of Law of Clary, J., filed and Order entered directing that judgment be entered in favor of plaintiff and against the defendant in the sum of $3,942.94, with interest on $985.74 from April 3, 1946, on $985.74 from June 24, 1946, on $985.73, from Sept. 25, 1946 and on $985.73 from December 17, 1946 pursuant to applicable provisions of Section 3771 of the Internal Revenue Code (26 USC Sec. 3771).

June 28. Pursuant to Findings of Fact and Conclusions of Law and Order, Judgment is hereby entered in favor of the plaintiff and against the defendant in the sum of $3,942.94 with interest on $985.74 from April 13, 1946, on $985.74 from June 24, 1946, on $985.73 from Sept. 24, 1946 and on $985.73 from December 17, 1946 pursuant to the applicable provisions of Section 3771 of the Internal Revenue Code (26 USC Sec. 3771). Stephen P. Laffey, Clerk.

Aug. 27. Notice of Appeal filed by defendant.

Aug. 27. Copy of Notice of Appeal mailed Clerk of Court of Appeals, and counsel of Record, also J. Clary.

[Caption omitted]

SUR PLEADINGS AND PROOF

This is an action instituted by plaintiff corporation under Section 1346 (a)(1) of the Judicial Code, 28 U.S.C. 1346 (a)(1) to recover the sum of $3,942.94 paid for income taxes for the calendar year 1945. From pleadings and proof I make the following

FINDINGS OF FACT

1. Stevenson-Chislett, Inc., a corporation, and the plaintiff herein, filed its Federal Income Tax Return for the calendar year 1945 with the Collector of Internal Revenue at Pittsburgh, Pennsylvania, on March 15, 1946, and it paid to him the income tax shown due on the return in the amount of $3,942.94 in installments as follows:

April 3, 1946	$ 985.74
June 24, 1946	985.74
September 25, 1946	985.73
December 17, 1946	985.73
	$3,942.94

No part of the said amount has ever been refunded or in any manner repaid.

2. On March 15, 1949, plaintiff filed with the aforesaid Collector a claim for refund of 1945 income tax, in the amount of $3,492.94, on the ground that plaintiff had sustained a loss by embezzlement, in the amount of $20,925.20, which was discovered during 1945; that said loss was not compensated for by insurance or otherwise; and that said loss had not been reflected in its 1945 return. The Commissioner of Internal Revenue

had rendered no decision on the claim for refund when this action was commenced on September 21, 1950.

3. Early in 1945, during an audit of plaintiff's books, a discrepancy of $24,135.14, as of December 31, 1944, was discovered between the accounts receivable control account in the general ledger and the total of the individual accounts receivable. Of this amount, $16,882.09 had been posted during October, 1944, as credits to the accounts receivable control account with no corresponding bank deposit. Later investigation determined that the exact amount of the discrepancy between the individual accounts receivable in the accounts receivable ledger and the accounts receivable control account in the general ledger as of December 31, 1944 amounted to $21,675.37.

4. Investigation revealed that the cashier-bookkeeper over a period of several years had manipulated the books and records of the plaintiff for the purpose of covering up cash shortages by accumulating for several months credit slips of individual accounts receivable accounts. Credit slips were posted in later months and there were usually several months of credit slips unposted to the accounts receivable control account in the general ledger.

5. The difference in the two accounts, $21,675.37, represented amounts embezzled from the plaintiff by a person or persons unknown. The said funds were not taken at one time but represented a succession of embezzlements covering an unascertained number of years. Because of the manipulation of the books and records by the cashier-bookkeeper, aided and abetted by an officer of the corporation, and the silence of other employees who knew of or suspected the manipulation, the responsible officers of the corporation did not discover the embezzlement and loss until 1945 when an audit and investigation disclosed the cash shortage.

6. The loss by embezzlement was not compensated for by insurance or otherwise.

7. In view of the series of embezzlements, the nature of the records available and the reluctance to cooperate on the part of the persons involved or suspected, it was a practical impossibility to ascertain the exact year or years in which the succession of shortages occurred.

8. An attempt to segregate the exact year or years in which such shortages occurred would have required a very detailed and extensive audit and investigation with no assurance that such investigation would have disclosed the actual dates of the acts of embezzlement.

9. Plaintiff used reasonable efforts and diligence under the circumstances of this case in attempting to ascertain the times at which the various embezzlements occurred.

10. Plaintiff made reasonable efforts to detect the identity of the guilty party or parties, including, among others, examination of the suspected persons by accountants and lawyers, detailed analyses of the personal bank accounts of suspected persons, and extended attempts to obtain a confession from the person toward whom suspicion most strongly pointed. It was only upon the considered advice of the plaintiff's attorneys that there was not sufficient basis to institute either civil or criminal action under the circumstances that the plaintiff abandoned its attempt to recover the amounts embezzled.

11. The plaintiff failed to deduct the said loss in its computation of net income in its return for the year 1945.

DISCUSSION

Throughout the trial of the case, and in its brief, the Government has taken issue with the plaintiff on several important facts; that the plaintiff has suffered a loss by embezzlement; that reasonable efforts were made

to attempt to place the dates of loss if they did occur; and that the plaintiff made reasonable efforts to determine the identify of, and obtain redress from, the guilty party or parties, if loss occurred.

The Government contends in this case that because of one fact elicited in a statement obtained from a witness and introduced in evidence at the trial, namely, that certain of the petty cash funds were used to pay for C.O.D. purchases, the plaintiff has failed to prove embezzlement. I do not so understand the evidence. It appeared clear to me that cash purchases were accounted for and that the amount, $21,675.37, represented unaccounted for shortages.

The Government further contends that if funds were embezzled or stolen, the loss was sustained in 1944 or in prior years to which it should have been apportioned. I agree that the actual thefts occurred in 1944 and prior years, and under ordinary circumstances should have been apportioned to those years. A detailed and extensive audit might have thrown some light upon the period during which the delays in posting took place, but such audit would have required checking with individual grocery store customers. This type of investigation would not only have been burdensome but presented little likelihood of success. Further, it is questionable whether such information would have ascertained the time of the acts of embezzlement. I find that under the circumstances it is not reasonable to require the taxpayer to expend substantial sums on an extensive audit which, at best, had little hope of success in fixing the times of the embezzlements which are the losses here claimed.

One contention of the Government has given me considerable concern, and that is its allegation that the plaintiff has failed to make a real effort to force an accounting from the person or persons who, according

to the evidence, might have been responsible for the shortage. The plaintiff can only be held to the exercise of reasonable diligence, and in this case I find that plaintiff did in fact exercise that degree of diligence required, by seeking the advice and assistance of competent auditors and attorneys. While Government counsel might disagree with the exercise of judgment by plaintiff's counsel in deciding against prosecution, and while I might likewise disagree, nevertheless, it is peculiarly the province of a lawyer to advise a client in a situation such as is involved in the present case. It is his responsibility to the client to evaluate the available evidence and on the basis of that evidence to properly advise the client as to what can or cannot be legally proved in either a civil or criminal action.

The taxpayer was entitled to rely upon the considered judgment and advice of its attorney. It is clear to me from the record that it gave to its counsel all available data and having done so it was entitled to rely upon counsel's advice that the evidence was insufficient to warrant the institution of either civil or criminal action. The plaintiff, therefore, exercised reasonable diligence in attempting to learn the identity of the guilty person or persons and in attempting to obtain redress.

The section of the Internal Revenue Code under which plaintiff claims the deduction is Section 23(f); 26 U.S.C., Sec. 23(f) which provides as follows:

> "Sec. 23. In computing net income there shall be allowed as deductions:
>
> * * * * *
>
> (f) LOSSES BY CORPORATIONS.—In the case of a corporation, losses sustained during the taxable year and not compensated for by insurance or otherwise."

CASES

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1952

NO. 79.

MARTHA L. ALISON

v.

THE UNITED STATES OF AMERICA.

On Certificate From the United States Court of Appeals for the Third Circuit.

BRIEF FOR MARTHA L. ALISON, Plaintiff-Appellant.

OPINIONS BELOW.

The Opinion of the District Court (R. 5, 6, 7 and 8) is reported at 97 F. Supp., 959.

The Court of Appeals did not file an Opinion, but certified a question of law involved to this Court (R. 11) concerning which it desired instruction for the proper decision of the case. This Court ordered the entire record sent up so that it may decide the entire matter in controversy (R. 11).

There are two apparently conflicting views of the law applicable to the facts as I have found them. The Court of Appeals for the Third Circuit in the case of the First National Bank of Sharon, Pa. v. Heiner, 66 F. 2d 925 (1933), held that an embezzlement occurring in a prior year could not be deducted in the year in which it was discovered but must be deducted in the year in which the loss occurred. On the other hand, in the case of Boston Consolidated Gas Company v. Commissioner of Internal Revenue, 128 F. 2d 473 (1942), the First Circuit held that the taxpayer could deduct in the year of discovery a loss occasioned by embezzlement of an employee where the actual date of occurrence of each separate act of embezzlement, as in this case, could not be ascertained.

Plaintiff has argued, and very persuasively, for the application of the apparently more liberal rule of the First Circuit. The opinion of Judge Woodbury in the Boston Consolidated Gas Company case stressed the fact that by the last sentence of Article 43-2 of the Treasury Regulation 86 (now Regulation 111, Sec. 29, 43-2), the Treasury Department itself provided that a loss from theft or embezzlement occurring in one year and discovered in another is *ordinarily* deductible for the year in which sustained, thereby impliedly recognizing that extraordinary situations warranted out of ordinary treatment. He further pointed out that while it was not the intent of Congress to permit a taxpayer to take a deduction for a loss in any year that might serve the taxpayer's particular purpose, it nevertheless was not the intent of Congress that such a rule should be inelastically and rigidly applied. He held, therefore, in that case that where a loss by embezzlement is discovered in one year, said loss having occurred in prior years but the dates of the takings of the funds could not be ascertained, that such a situation did not

call for the application of the *ordinary* rule but required the application of an extraordinary rule and therefore allowed the deduction in toto for the year in which it was discovered.

Judge Woodbury in his opinion in the Boston Consolidated Gas Company case, at page 476, regarded the ruling of the Third Circuit in the Sharon Bank case as conflicting with his. I do not agree. As I view the Sharon Bank case, the principal point upon which the case was decided was that an embezzlement may not be treated as a bad debt. A review of the record on appeal in that case reveals that it was decided upon a statement of claim and an affidavit of defense raising questions of law. It, therefore, leaves an area of doubt regarding certain facts of the case. The statement of claim alleged a total embezzlement by a bank employee during the years 1922, 1923, 1924, 1925, 1926, 1927 and 1928 of some $95,360.00 of which sum recovery was had from the defaulting employee and a bonding company of all but $20,000.00, which represented the amount embezzled prior to the coverage date of the bond.

Even after a review of the record on appeal, it is not clear whether the dates of the embezzlements were definitely ascertained. There were several factors, however, indicating that the times of embezzlement were actually known. For example, in the statement of claim it was alleged that $20,000.00 of the amount embezzled had not been recovered from the surety company because the embezzlement of that amount took place before the coverage date of the bond. This is an indication that the time of loss was known with at least some degree of accuracy. There is a further indication from the opinion of Judge Gibson in the lower Court, 2 F. Supp. 960 that the time of embezzlement was known. He stated at page 961, "* * * Unfortunately the period has expired during which an amended return could be filed

for the year of the embezzlement * * *". These two factors indicate that the times of loss were known. If they were, then the rulings in the Sharon Bank and the Boston Consolidated Gas Company cases are not inconsistent. The statement made in the opinions of both the District Court and the Court of Appeals, in the former case, that the deductions for embezzlement loss could be taken only in the year in which the embezzlement took place is, therefore, a statement of the general rule recognized by the First Circuit that ordinarily loss by embezzlement must be deducted in the year in which sustained.

The Court of Appeals for the Third Circuit has not, in my opinion, ruled squarely upon the question whether embezzlement losses, the actual dates of occurrence of which are unknown, are deductible in the year of discovery.

In view of the similarity of facts between the present case and the Boston Consolidated Gas Company case, it appears to me that the holding in that case is the only appellate authority in point on the facts and, therefore, controlling. Therefore, plaintiff's claimed deduction must be allowed and it is entitled to judgment in its favor.

CONCLUSIONS OF LAW

1. Stevenson-Chislett, Inc., plaintiff herein, prior to the taxable year 1945 sustained an embezzlement or theft loss in the amount of $21,675.37 which loss was discovered during the year 1945.

2. The embezzlement or theft loss, $21,675.37, composed of a series of embezzlements extending over a period of years, the exact dates of each separate act of embezzlement being unknown, is a proper deduction from gross income by the plaintiff for the taxable year in which discovered, 1945, under the provisions of Sec-

tion 23(f) of the Internal Revenue Code. 26 U.S.C. Sec. 23(f).

3. Plaintiff is entitled to judgment in the sum of $3,942.94, with interest.

An appropriate order will be entered.

[Caption omitted]

ORDER

AND NOW, to wit, this 28th day of June, A. D. 1951, for the reasons set forth in the Findings of Fact and Conclusions of Law filed in this case, it is

ORDERED, ADJUDGED AND DECREED that judgment be entered for the plaintiff and against the defendant in the amount of $3,942.94, with interest on $985.74 from April 3, 1946, on $985.74 from June 24, 1946, on $985.73 from September 25, 1946 and on $985.73 from December 17, 1946, pursuant to the applicable provisions of Section 3771 of the Internal Revenue Code, (26 U.S.C., Sec. 3771).

By the Court:

(S.) THOMAS J. CLARY,
D.J.

☆ U. S. GOVERNMENT PRINTING OFFICE: 1952 931796 890

13a In United States Court of Appeals for the Third Circuit

No. 10599

[Title omitted.]

Certificate to the Supreme Court of the United States

To the Honorable, the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Statement of Facts

In the above-entitled case an appeal has been taken to this court by the defendant, the United States of America, from a judgment of the United States District Court for the Western District of Pennsylvania entered on June 28, 1951, in favor of the plaintiff, Stevenson-Chislett, Inc., a corporation, in a civil action instituted under Title 28, United States Code, § 1346 (a) (1), to recover the sum of $3,942.94 paid by the plaintiff for income taxes for the calendar year 1945.

14a From the pleadings and proof the district court made the following findings of fact which are not controverted by the parties on this appeal, namely:

"1. Stevenson-Chislett, Inc., a corporation and the plaintiff herein, filed its Federal Income Tax Return for the calendar year 1945 with the Collector of Internal Revenue at Pittsburgh, Pennsylvania, on March 15, 1946, and it paid to him the income tax shown due on the return in the amount of $3,942.94 in installments as follows:

April 3, 1946	$985.74
June 24, 1946	985.74
September 25, 1946	985.73
December 17, 1946	985.73
Total	3,942.94

No part of the said amount has ever been refunded or in any manner repaid.

"2. On March 15, 1949, plaintiff filed with the aforesaid Collector a claim for refund of 1945 income tax, in the amount of $3,492.94, on the ground that plaintiff had sustained a loss by embezzlement, in the amount of $20,925.20, which was discovered during 1945: that said loss was not compensated for by insurance or otherwise; and that said loss had not been reflected in its 1945 return. The Commissioner of Internal Revenue had rendered no decision on the claim for refund when this action was commenced September 21, 1950.

"3. Early in 1945, during an audit of plaintiff's books, a discrepancy of $24,135.14, as of December 31, 1944, was discovered between the accounts receivable control account in the general ledger and the total of the individual accounts receivable. Of this amount, $16,882.09 had been posted during October, 1944, as credits to the accounts receivable control account with no corresponding bank deposit. Later investigation determined that the exact amount of the discrepancy between the individual accounts receivable in the accounts receivable ledger and the accounts receivable control account in the general ledger as of December 31, 1944 amounted to $21,675.37.

"4. Investigation revealed that the cashier-bookkeeper over a period of several years had manipulated the books and rec-
15a ords of the plaintiff for the purpose of covering up cash shortages by accumulating for several months credit slips of individual accounts receivable accounts. Credit slips were posted in later months and there were usually several months of credit slips unposted to the accounts receivable control account in the general ledger.

"5. The difference in the two accounts, $21,675.37, represented amounts embezzled from the plaintiff by a person or persons unknown. The said funds were not taken at one time but represented a succession of embezzlements covering an unascertained number of years. Because of the manipulation of the books and records by the cashier-bookkeeper, aided and abetted by an officer of the corporation, and the silence of other employees who knew of or suspected the manipulation, the responsible officers of the corporation did not discover the embezzlement and loss until 1945 when an audit and investigation disclosed the cash shortage.

"6. The loss by embezzlement was not compensated for by insurance or otherwise.

"7. In view of the series of embezzlements, the nature of the records available and the reluctance to cooperate on the part of the persons involved or suspected, it was a practical impossibility to ascertain the exact year or years in which the succession of shortages occurred.

"8. An attempt to segregate the exact year or years in which such shortages occurred would have required a very detailed and extensive audit and investigation with no assurance that such investigation would have disclosed the actual dates of the acts of embezzlement.

"9. Plaintiff used reasonable efforts and diligence under the circumstances of this case in attempting to ascertain the times at which the various embezzlements occurred.

"10. Plaintiff made reasonable efforts to detect the identity of the guilty party or parties, including, among others, examination

of the suspected persons by accountants and lawyers, de-
16a tailed analyses of the personal bank accounts of suspected persons, and extended attempts to obtain a confession from the person toward whom suspicion most strongly pointed. It was only upon the considered advice of the plaintiff's attorneys that there was not sufficient basis to institute either civil or criminal action under the circumstances that the plaintiff abandoned its attempt to recover the amounts embezzled.

"11. The plaintiff failed to deduct the said loss in its computation of net income in its return for the year 1945."

The district court filed an opinion, which is reported in 98 F. Supp. 252, and reached the following conclusions of law:

"1. Stevenson-Chislett, Inc., plaintiff herein, prior to the taxable year 1945 sustained an embezzlement or theft loss in the amount of $21,675.37 which loss was discovered during the year 1945.

"2. The embezzlement or theft loss, $21,675.37, composed of a series of embezzlements extending over a period of years, the exact dates of each separate act of embezzlement being unknown, is a proper deduction from gross income by the plaintiff for the taxable year in which discovered, 1945, under the provisions of Section 23 (f) of the Internal Revenue Code. 26 U. S. C. Sec. 23 (f).

"3. Plaintiff is entitled to judgment in the sum of $3,942.04, with interest."

Thereupon the district court entered the following judgment:

"And now, to wit, this 28th day of June, A. D. 1951, for the reasons set forth in the Findings of Fact and Conclusions of Law filed in this case, it is

"Ordered, adjudged and decreed that judgment be en-
17a tered for the plaintiff and against the defendant in the amount of $3,942.94, with interest on $985.74 from April 3, 1946, on $985.74 from June 24, 1946, on $985.73 from September 25, 1946 and on $985.73 from December 17, 1946, pursuant to the applicable provisions of Section 3771 of the Internal Revenue Code (26 U. S. C., Sec. 3771).

"By the Court:

THOMAS J. CLARY,
D. J."

The present appeal to this court was then taken by the appellant. The appeal was heard by three judges of this court on February 20, 1952. Thereafter a rehearing before the court in banc was ordered by a majority of the circuit judges and was held on April 21, 1952 before six judges of the court, the seventh judge being disqualified to act. The six judges of the court who sat in the rehearing of this case being equally divided in opinion as to whether the plaintiff's loss of $21,675.37 by embezzlement was deductible

in computing its taxable net income for the year 1945 in which the loss was discovered, the court hereby certifies the following question of law concerning which it desires instruction for the proper decision of the case, to wit:

Question presented

When a taxpayer has suffered embezzlements over a period of years prior to 1945 but the actual years in which the several acts
18a of embezzlement took place are unknown and it is a practical impossibility to ascertain them, are the losses resulting from such embezzlements deductible by the taxpayer under Section 23 of the Internal Revenue Code in computing its taxable net income for the year 1945, in which year the embezzlements were discovered and the net loss therefrom was ascertained?

JOHN BIGGS, Jr.
Chief Judge.
ALBERT B. MARIS,
Circuit Judge.
HERBERT F. GOODRICH,
Circuit Judge.
GERALD McLAUGHLIN,
Circuit Judge.
H. E. KALODNER,
Circuit Judge.
WILLIAM H. HASTIE,
Circuit Judge.

19a [Clerk's Certificate to foregoing transcript omitted in printing.]

20a Supreme Court of the United States

No. 793, October Term, 1951

THE UNITED STATES OF AMERICA

v.

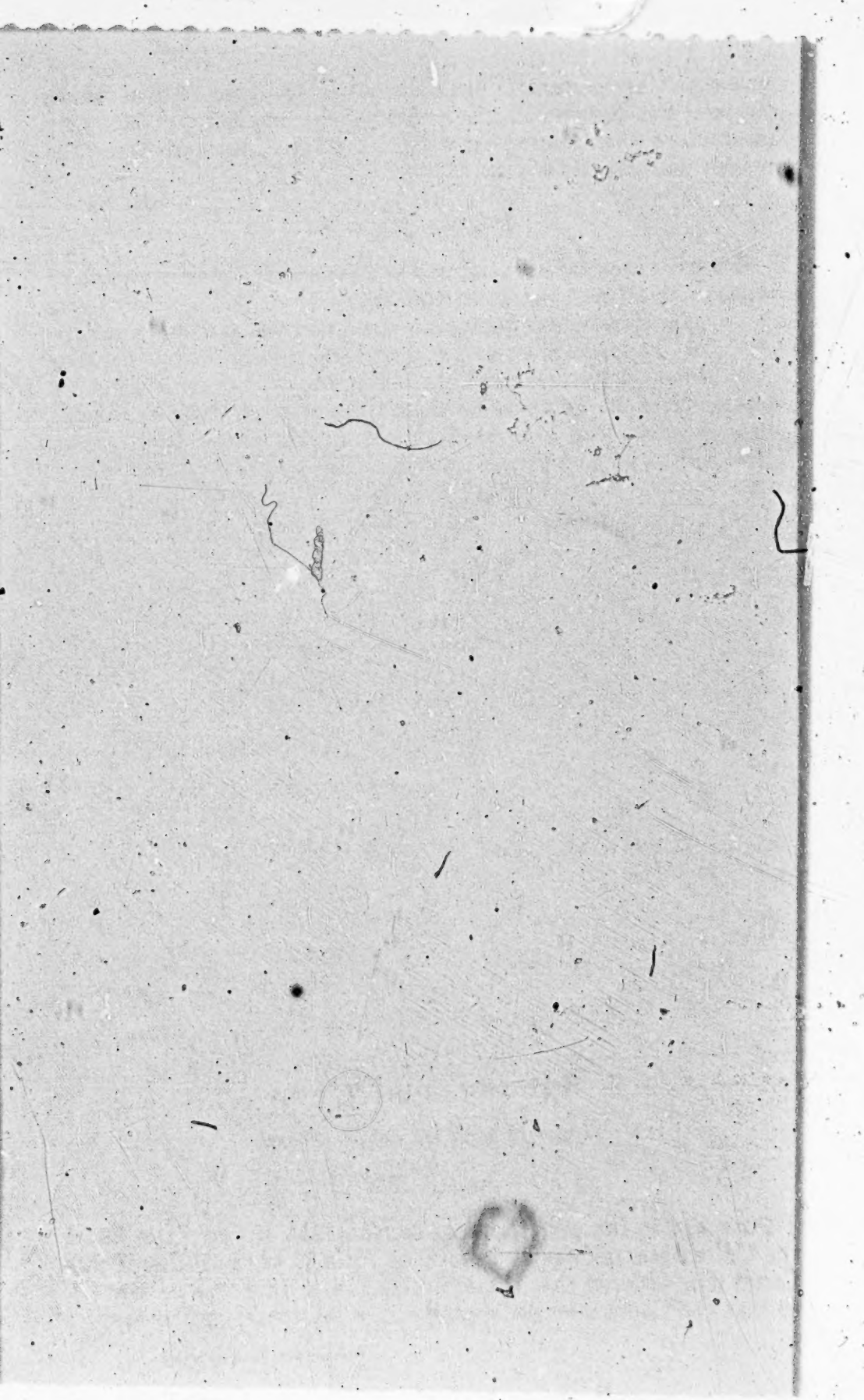
STEVENSON-CHISLETT, INC.

Order to send up entire record

June 9, 1952

Pursuant to the provisions of section 1254 (3) of Title 28 of the United States Code and par. 2 of Rule 37 of the Rules of this Court it is ordered that the entire record in this case be sent up so that the Court may decide the entire matter in controversy.

U. S. GOVERNMENT PRINTING OFFICE: 1952



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v.

THE UNITED STATES OF AMERICA.

On Certificate From the United States Court of Appeals for the Third Circuit.

BRIEF FOR MARTHA L. ALISON, Plaintiff-Appellant.

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OPINIONS BELOW.

The Opinion of the District Court (R. 5, 6, 7 and 8) is reported at 97 F. Supp., 959.

The Court of Appeals did not file an Opinion, but certified a question of law involved to this Court (R. 11) concerning which it desired instruction for the proper decision of the case. This Court ordered the entire record sent up so that it may decide the entire matter in controversy (R. 11).

JURISDICTION.

This Court has jurisdiction by virtue of 28 U.S.C., Section 1254 (3). The judgment to be reviewed was entered by the District Court for the Western District of Pennsylvania on May 17, 1951 (R. 10).

QUESTION PRESENTED.

Where a taxpayer sustains a loss by embezzlement, the fact of embezzlement and the exact dates of each separate act of embezzlement being unknown to her, is the embezzlement or theft loss deductible from gross income by the taxpayer for the taxable year in which the embezzlement or theft loss is discovered, under Section 23 (e) of the *Internal Revenue Code,* 26 U.S.C.A. 23 (e)?

STATUTES AND REGULATIONS INVOLVED.

Internal Revenue Code:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * * * *

(e) LOSSES BY INDIVIDUALS.—In the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

* * * * * * *

(3) of property not connected with the trade or business, if the loss arises from fires, storms, shipwreck, or other casualty, or from theft. * * *

* * * * * * *

(26 U. S. C. 1946 ed., Sec. 23.)

SEC. 43. PERIOD FOR WHICH DEDUCTIONS AND CREDITS TAKEN.

The deductions and credits * * * provided for in this chapter shall be taken for the taxable year in which "paid or accrued" or "paid or incurred", dependent upon the method of accounting upon the basis of which the net income is computed, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period. * * *

(26 U. S. C. 1946 ed., Sec. 43.)

Treasury Regulations 103, promulgated under the Internal Revenue Code:

SEC. 19.23 (e)-1. *Losses by Individuals.*— Losses sustained by individual citizens or residents of the United States and not compensated for by insurance or otherwise are fully deductible if * * * (c) arising from fires, storms, shipwreck, or other casualty, or theft, * * *.

SEC. 19.43-2. *When Charges Deductible.*— * * * A loss from theft or embezzlement occurring in one year and discovered in another is ordinarily deductible for the year in which sustained.

STATEMENT.

In this case, Martha L. Alison, appellant in the Court below, and who will hereinafter be referred to as the taxpayer or appellant, seeks to recover from the United States of America, the sum of $2843.78, plus interest, as the result of an overpayment of her income tax for the year 1941. The case in the District Court was tried by the Court without a jury, upon the pleadings and the written Stipulation of the facts.

The action was brought against the United States of America pursuant to the provisions of Section 24 of the *Judicial Code,* as amended, 28 U.S.C.A., Section 41 (20).

The action arises under the Internal Revenue Laws of the United States and the applicable statute is Section 23 (e) of the *Internal Revenue Code,* 26 U.S.C.A. Section 23 (3), which provides as follows:

> "In computing net income there shall be allowed as deductions * * * (e) in the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise * * * (3) or from theft."

Appellant taxpayer in this case filed her income tax return for the year 1941, but inadvertently failed to deduct from her gross income a loss sustained by her on November 24, 1941 in the amount of $21,804.90, which resulted in an overpayment of her income tax in the amount of $2,843.78. She thereafter, on or about March 30, 1943, filed a claim for refund for the year 1941 for this overpayment, which claim for refund was disallowed by the Commissioner of Internal Revenue on the theory that the loss which was claimed as a deduction for the

year 1941 was an embezzlement attributable to the years 1931 to 1940, and did not occur in 1941.

Suit was filed in the Court below for the refund pursuant to the provisions of Section 24 of the *Judicial Code* as amended, 28 U.S.C.A., Section 41 (20), on the theory that the fact of embezzlement was not known and the loss was not discovered or sustained until the year 1941, and that deduction for this loss should have been allowed for the year 1941 under the statutes and decisions arising thereunder.

One J. W. Cree, prior to his death on November 24, 1941, was the manager of several trust estates and also a business agent and adviser for a large number of persons. Among his clients was the appellant in this case, whose maiden name was Martha Liggett. When the appellant was a minor, Mr. Cree was her guardian, and after she became of age, Mr. Cree continued as her business agent and adviser. The appellant's chief source of income was from real estate and securities and Mr. Cree had complete control and possession of the funds and property of the appellant. There was no written agreement between the appellant and Mr. Cree respecting the funds and securities and no accounting was ever requested or given by Mr. Cree. The account of the appellant, as well as other trust accounts, was carried in a separate set of books called the "J. W. Cree, Jr., Trust Account", the funds of which were commingled with his own personal funds. The securities were likewise carried in the name of J. W. Cree, Jr. None of these latter facts were known to appellant until after the death of said Cree (R. 9).

Shortly after the death of Mr. Cree, the appellant found from an examination of his books and records

that there was due her cash in the amount of $30,155.37, which sum was not available for the reason that Mr. Cree had commingled those funds with those of his own and had been using them for his personal benefit. The appellant was the largest creditor of Mr. Cree's estate and inasmuch as the estate did not have sufficient funds to pay all creditors, an agreement was reached whereby the appellant took a loss of $21,804.90 on her claim, which included a cash payment of $3,380.95 to the appellant by a creditor of Mr. Cree's estate. This cash payment was made to the appellant under date of November 18, 1942. After these transactions were completed the appellant's loss arising out of the settlement amounted to $21,804.90 (R. 9).

Throughout the period from 1931 to the date of Mr. Cree's death on November 24, 1941, Mr. Cree was a director in several banks and prominent in real estate circles as well as in business circles in the City of Pittsburgh. He enjoyed substantial credit and had a reputation of meeting all his obligations as they accrued (R. 10).

The amounts taken by Mr. Cree and the amounts paid back to the appellant, as shown by Mr. Cree's personal books, which were discovered for the first time after his death and of which appellant had no knowledge, are as follows (R. 4):

Years	Amount Taken	Amount Paid Back	Net Amount Embezzled
1931	$ 8,000.00	$2,000.00	$ 6,000.00
1932	500.00	.....	500.00
1934	2,000.00	.....	2,000.00
1935	3,000.00	.....	3,000.00
1936	4,800.00	500.00	4,300.00
1937	2,000.00	.....	2,000.00
1938	4,950.00	1,450.00	3,500.00
1939	4,300.00	.....	4,300.00
1940	1,500.00	.....	1,500.00
1941	.....	.....	.....
	$31,050.00	$3,950.00	$27,100.00
Add: "Uninvested principal in principal (stock) Acc't"			3,055.37
Total uninvested cash embezzled			$30,155.37

The appellant had no reason to suspect that any of her funds were being embezzled by Mr. Cree and had no knowledge of such embezzlement until after his death (R. 4).

Taxpayer's chief source of income was from real estate and securities, and Mr. Cree had complete control and possession of the funds and property of the appellant, and it is also stated that there was no accounting nor was one ever requested, or given by Mr. Cree (R. 3). This is not to be construed to mean that Mr. Cree during the period from 1926, when Mr. Cree ceased to be appellant's legal guardian, until the time of his death on November 24, 1941, failed to account for income received on appellant's property and investments. Accounting for income and payment thereof to the appel-

lant was made regularly up to the time of Mr. Cree's death.

The District Court was of the opinion that the plaintiff was entitled to take the deduction in the year of discovery (R. 7) but felt bound by precedent in this Circuit (*First National Bank of Sharon, Pa. v. Heiner*, 66 Fed. 2d. 925 (1933) to hold against her. Had it not been for this decision, the Court would have followed the later decision of the First Circuit in *Boston Consolidated Gas Co. v. Commissioner of Internal Revenue*, 128 Fed. 2d. 473 (1942) and found in her favor (R. 7).

On appeal by the taxpayer to the Court of Appeals, after two oral arguments, that Court was unable to arrive at a decision and, after certification of the question of law involved, the entire record is now before this Honorable Court for final disposition.

SUMMARY OF ARGUMENT.

It is the contention of appellant that under all of the facts of this case, the law applicable thereto and the decisions of this and lower Courts, that she is entitled to deduct the loss by embezzlement for the year 1941 when it was discovered by her, and that the decision of the District Court was erroneous. The taxpayer did not sustain a deductible loss until, upon the death of the embezzler in 1941, the defalcation was discovered. That is the identifiable event which fixes the time for the deduction.

As held by this Court in *Commissioner v. Wilcox*, 327 U.S., 404 (1946) an embezzler, when appropriating money, incurs a continuous obligation to repay, and the

embezzled money does not constitute taxable income to him.

It is admitted that the taxpayer in this case had absolutely no knowledge of the misappropriation of her property, and the secret records of the Trustee were discovered only after his death. They may or may not have represented the actual facts, but apparently it was a record of the amount he owed to his principal, which only came to light by reason of his death.

In the Court below, counsel for the Government argued that it was the gist of taxpayer's contention that the taxable period within which a deduction for a loss arising from embezzlement must be taken is to be determined solely by a subjective test and that this contention was specifically rejected by this Court in *Boehm v. Commissioner*, 326 U.S., 287 (1945).

Counsel here contends that the question of a subjective test is not involved in this case and, on the contrary, the fact of the discovery of the embezzlement and the death of the embezzler are objective events which have nothing whatever to do with the state of the taxpayer's mind.

The *Boehm Case* cited by the Government in support of its contention is not in point because, in that case, the issue was when certain corporate stock became worthless for income tax purposes. The taxpayer contended that he could determine this time solely on his opinion as to when the stock became worthless.

The Court held, however, that this was a question of fact for The Tax Court to determine since the facts showed a succession of identifiable events which occurred prior to the year contended so as to justify the

conclusion that the stock was worthless prior to the year claimed by the taxpayer.

The facts in this case are that the state of the taxpayer's mind is not involved since it was stipulated that the bona fide discovery of the embezzlement was made in 1941 and that taxpayer had no knowledge of or reason to know of the embezzlement prior to the death of the Trustee (R. 10).

The Government further contended in its argument below that the decision of the Court of Appeals in the case of *Boston Consolidated Gas Co. v. Commissioner*, 128 Fed. 2d, 473, is a clear departure from the plain intent of the statute and from the principles enunciated by the Supreme Court, and should be overruled.

It is our contention that the said *Boston Consolidated Gas Co. Case* is in full accord with the law. It has since been followed by decisions in The Tax Court and acquiesced in by the Commissioner of Internal Revenue, and should be decisive of the issue involved in this case.

The Government contends that the *Boston Consolidated Gas Co. Case* is in effect a judicial amendment of statutes. With this we do not agree, and contend that the decision is an interpretation of the statute and the regulations which should be followed.

The cases are in confusion as to the period in which embezzlement losses are deductible. In the first place, Congress created uncertainty when it stated that losses by individuals are deductible in the year in which "sustained", without defining what was meant by "sustained". The word has different meanings, and in such losses as those by embezzlement, which are unknown losses and which, by their very nature, stand in a category of their

own, it is clear that a loss is not sustained until discovered, regardless of when it actually occurred.

The Treasury Department's Regulation (P. 10) sustains the taxpayer's position by providing that embezzlement losses are *ordinarily* deductible for the year in which sustained. From this language it would seem that the Government itself contemplates certain situations wherein the deduction would be allowable in a year other than the year in which the loss occurs.

In view of the above, it is obvious that the Court of Appeals in the First Circuit, in the *Boston Consolidated Gas Co. Case, supra,* clarified by judicial action a law where uncertainty existed. This is fully justified under the wording of the statute and the regulation because the Treasury Department, in using the word "ordinarily", contemplates that certain situations might give rise to different treatment, and since the statute and the regulation fail to specify the situation, it is certainly within the power of the Court to do so.

The running of the statutory time limit for claiming a refund should be considered a special case calling for allowance of the deduction in the year of *bona fide* discovery so far as embezzlement losses are concerned.

ARGUMENT.

I.

The Loss Did Not Occur Until 1941.

According to the record in this case, Mr. Cree, the embezzler, had acted as guardian for the appellant until she became of age and thereafter until the time of his death on November 24, 1941, acted as agent and trustee for the appellant, and it must be assumed that since there is nothing to indicate otherwise, Mr. Cree discharged his duties as guardian in a manner beyond reproach. He was also manager of several trust estates, was a director in several banks and prominent in real estate circles, as well as in business circles in the City of Pittsburgh, enjoyed a substantial credit and had a reputation of meeting all his obligations as they accrued. For this reason, as well as her implicit confidence in Mr. Cree, the appellant did not have the slightest suspicion of what was discovered upon his death. There is nothing whatever in the relationship between these parties, and keeping in mind the reputation of Mr. Cree, that appellant would have any way whatsoever of ascertaining that any of her property had been misappropriated until the time of Mr. Cree's death.

According to the Stipulation, Mr. Cree's books, as set forth in the Statement of the Case, indicated that certain amounts of money were taken at various times beginning in 1931 and ending in 1940. Appellant was in complete ignorance of these facts and even though Mr. Cree's personal books may have indicated to the Commissioner of Internal Revenue that the embezzlement took place in the years indicated, we do not agree

with his conclusion. It is quite clear from the facts of the case that had the appellant at any time during Cree's life time, made claim for any money due her from him, he would, by reason of his financial connections, excellent credit and reputation, have been able to and would actually have made payment to appellant of the full amount due and owing by him to her. His death and the condition of his estate made repayment to appellant of the full sum due her impossible. The result was that the moneys taken and used by Cree and which he could have paid at any time up to his death in 1941 were, because of Cree's fiduciary relation to plaintiff, as a matter of fact embezzled, but could not be considered as such until it was discovered and ascertained in the year 1941.

We refer the Court to the concurring Opinion of Magruder, Circuit Judge, in *Boston Consolidated Gas Company v. Commissioner of Internal Revenue*, 128 Fed. 2nd, 473 (First Circuit, 1942), in which he considers that analytically the taxpayer did not sustain a loss at the time of the embezzlement from its cash account. The money in the embezzler's hands still belonged to the taxpayer, and at most there had only been a change in the form of the taxpayer's assets. He further held, page 477:

> "In the recent case of McKnight v. Commissioner, 127 F. 2d 572, decided by the Circuit Court of Appeals for the Fifth Circuit, April 29, 1942, it was held that the embezzler of money, who is unable to restore it, does not make a taxable gain thereby. The court said: 'By the taking the embezzler incurs an equivalent debt as surely as if he had borrowed with the consent of the owner. The first takings are, indeed, nearly always with the intention of re-

paying, a sort of unauthorized borrowing. It must be conceded that no gain is realized by borrowing, because of the offsetting obligation. This would be true even though at the time there was no intention to repay. It seems to us that the same thing is true of each act of embezzlement.' If at the time of the embezzlement the wrongdoer makes no gain, because of the offsetting obligation, it seem logical to hold that the person whose money is taken does not at that time sustain a loss. Cf. Douglas County Light & Water Co. v. Commissioner, 9 Cir., 1930, 43 F. 2d 904. Logic here coincides with practical convenience, because, as pointed out by Judge Woodbury, if the Government's view is accepted, the wronged party will often be deprived unjustly of a tax deduction through inability to prove the specific amounts embezzled in any particular year. The same injustice would also result if the taxpayer did not discover an embezzlement until too late to file an amended return and to claim a refund for the year in which the money was taken."

II.

Statutes Authorizing Deductions Should Be Liberally Construed.

The Courts have held that provisions of the statute authorizing a taxpayer to deduct losses in computing income tax, being relief measures, should be liberally construed in favor of the taxpayer. *Burnet, Commissioner of Internal Revenue, v. Marston,* 57 Fed. 2d, 611. Also, it has been held that Internal Revenue Laws should be construed and applied with a view of avoiding, so far as possible, unjust and oppressive consequences. *Farmers Loan and Trust Co. v. Minnesota,* 280 U.S., 204, 212. *Lucas v. American Coat Co.,* 280 U.S. 445, in which it is said:

> "The general requirement that losses be deducted in the year in which they are sustained calls for a practical, not a legal, test."

As will be noted by referring to the Statement of the Case, if the appellant in this case is not permitted to deduct her loss for the year 1941, she is forever precluded from asserting the deduction for any other years for the reason that she did not discover the embezzlement until too late to file an amended return and to claim a refund for the year in which the money was taken. According to the books, the money was taken during the years 1931 to 1940, inclusive, and by the time the Commissioner of Internal Revenue had acted on the claim for refund in the 1942 return, it was too late for the appellant to file claims for refund for the years in question. This certainly works an unjust and oppressive consequence which is not sanctioned by the Courts.

In the case of taxes imposed by the 1934 or subsequent Acts, the period of limitation is three years from the time the return was filed, or two years from the time the tax was paid, whichever expires later (Int. Rev. Code, Sec. 322). In case of taxes imposed by the 1932 and 1928 Acts, the limitation is two years from the time the tax was paid.

Keeping the above limitation in mind, the taxpayer would be deprived entirely of any right to charge off the embezzlements alleged to have occurred during the years 193[illegible] to 1937, inclusive, in the total amount of $17,800.00, which was disclosed solely by Mr. Cree's personal books, and of which the taxpayer had no knowledge.

To be practical and to promote uniformity, the year of bona fide discovery should be the criterion.

III.

Embezzlement Losses Should Be Deductible in the Year of Discovery.

It is respectfully contended that the decision of the First Circuit Court of Appeals in the case of *Boston Consolidated Gas Company v. Commissioner of Internal Revenue,* 128 Fed. 2d, 473, decided in 1942, and since followed by decisions in other Courts, should be approved by this Honorable Court, and the law set forth therein clearly established as the law of the land.

In that case the petitioner's treasurer and head cashier died on January 30, 1935, having last worked on January 21st of that year. An audit of the petitioner's books made during 1935 showed that he had embezzled $99,139.09, $98,323.55 of which had been embezzled before December 31, 1934. No shortage through embez-

zlement was brought to light by an audit of the petitioner's books in 1933 and 1934 and in 1935 taxpayer claimed as a deduction in its 1935 income tax return the shortage ascertained to be $61,539.94. The Commissioner and the Board of Tax Appeals refused to allow the deduction on the ground that the loss must be deducted in the year in which it is sustained even though it is not discovered until a later year. The Circuit Court, in reversing the Board of Tax Appeals (Woodbury, Circuit Judge), held:

> "So far as we can determine the Supreme Court of the United States has not spoken on this question except to say by way of dictum in Burnet v. Huff, 288 U.S. 156, 159, 53 S. Ct. 330, 331, 77 L. Ed. 670, that: 'The Government concedes that if assets of the taxpayer used in trade or business or "in any transaction entered into for profit," are stolen in any year, the taxpayer sustains the loss in that year and the deduction must then be taken even though the theft is not discovered or the amount ascertained until the following year.' More direct authority for the Commissioner's view, however, is found in First National Bank of Sharon, Pa., v. Heiner, 3 Cir., 66 F. 2d 925, and Borden v. Commissioner, 2 Cir., 101 F. 2d 44.
>
> "In the First National Bank of Sharon case the United States Circuit Court of Appeals for the Third Circuit held that a loss sustained by the taxpayer through embezzlement prior to 1928, but not discovered until that year, could not be deducted as a 1928 loss, and the United States Circuit Court of Appeals for the Second Circuit ruled similarly in the Borden case, although in that case the loss was

discovered before the date for filing the return for the year when the theft occurred.

"On the other hand the Circuit Court of Appeals for the Sixth Circuit in Glenn v. Louisville Trust Co., 124 F. 2d 418, 420, held that a loss sustained by a taxpayer through the unauthorized and improvident investment of his money by an agent or trustee could be taken in 1933, the year when the loss was adjusted and settled, even though the defalcation resulted in loss in 1930 and was discovered in 1931. In this case the court concluded its opinion with the statement: 'Viewing the problem realistically, as we are enjoined to do by authorities so numerous that citation becomes superfluous, we conclude that upon whatever theory Pirtle or his estate suffered a loss through the unauthorized investment of his funds, the loss was suffered in 1933 when the extent of it first was ascertained.'

"While this case is not squarely in point, it seems to us to indicate the proper point of view from which to look at the problem presented by this phase of the case at bar. From the statute it is evident that Congress intended to permit taxpayers to deduct the net amount of their legitimate losses, but, for obvious reasons, Congress did not intend to permit a taxpayer to take a deduction for a loss in any year which might serve his interest. So, to accomplish its purpose, Congress naturally provided that losses should be taken in the year in which sustained. But, looking at the scheme devised for the taxation of incomes as a whole, and construing and applying the statute 'with a view of avoiding, so far as possible, unjust and oppressive conse-

quences', (Farmers' Loan & Trust Co. v. Minnesota, 280 U.S. 204, 212, 50 S. Ct. 98, 100, 74 L. Ed. 371, 65 A.L.R. 1000) we believe that Congress did not intend that its rule should be inelastically and rigidly applied, and this we think the Treasury Department recognized when it used the word 'ordinarily' in the last sentence of Article 43—2 of its Regulations 86.

"Doubtless in the majority of cases of the sort under consideration the end contemplated could be accomplished by filing in the year of discovery an amended return for the year of loss. But when as here no such amended returns could be filed by the petition because it was unable to determine the actual dates of the different acts of embezzlement, the results of which together caused its gross loss of nearly one hundred thousand dollars, we believe that the situation is so extraordinary that its total net loss may be deducted in the year when the loss was discovered and its extent determined, that is, 1935."

The decision in the above case has been followed as follows:

In the case of *Maria G. Miglietto* TC Memo Opinion Docket 108679 January 28, 1943, the taxpayer's funds were embezzled by her father while acting as her guardian during the years 1934 to 1938, inclusive. The taxpayer did not discover the loss until 1939 when her father told her of his misconduct. In that case The Tax Court permitted the deduction to be taken in the year 1938 where the Commissioner was attempting to impose a deficiency assessment for 1938.

In *Gwinn Bros. & Co. v. Comissioner of Internal Revenue,* 7 TC 320 (1946) the taxpayer in 1935 discovered that an employee had embezzled large sums from it commencing prior to 1932. The Commissioner allowed some deductions for the misappropriated funds for the years 1932 to 1935, leaving a balance above $44,000.00 undeducted in the latter year. The Court held that the petitioner could deduct its total net loss in 1935, which was the year the loss was discovered and its extent determined.

In *Samuel M. Felton,* 5 T.C. 256 (1945), the taxpayer in 1938 gave $20,000 to an agent to invest for him. The agent had been in the business of managing funds for others for five years under contracts permitting the intermingling of funds. In 1940 the agent absconded, and thereafter in the same year the taxpayer learned that the agent had actually been insolvent since 1933. The taxpayer claimed that the loss was deductible in 1940 when he first discovered the embezzlement, but the Commissioner contended that the loss was incurred sometime prior to 1940. The Tax Court allowed the loss in 1940, pointing out that until the agent absconded his scheme of manipulation was working, that because of the intermingling of funds it was impossible for the taxpayer to ascertain the exact year in which his own funds had been misappropriated, and that under these facts he should not be compelled to do so. The Commissioner published his acquiescence in the decision: 1945 *Cum. Bull.* 3.

Conclusion.

We believe and contend that the Treasury Department of the United States, through its Commissioner of Internal Revenue, has attempted to follow too literally and stringently the regulation that a loss from theft or embezzlement occurring in one year and discovered in another year is ordinarily deductible for the year in which sustained. *Income Tax Regulations* 111, Section 29.43—2. The word *"ordinarily"* has been lost sight of in this case. It is clear from the consideration of all of the facts in this case that the situation is here singularly *extraordinary*. The reasoning of the Court in the *Boston Consolidated Gas Company Case, supra,* is so clear that we are at a loss to understand how the Treasury Department could refuse the appellant the deduction in the manner claimed. The action of the Treasury Department in disallowing the deduction is quite unjust and oppressive to this appellant under the peculiar circumstances herein set forth. We do not believe that Congress intended that a taxpayer should be deprived unjustly of a tax deduction where the circumstances so clearly indicate that the year 1941 was the only year for which the deduction could properly be claimed. As stated by the Court in the *Boston Consolidated Gas Company Case*, it is evident from the Statute that Congress intended to permit taxpayers to deduct the net amount of their legitimate losses, but, for obvious reasons, Congress, did not intend to permit a taxpayer to take a deduction for a loss in any year which might serve his purpose. Congress did not intend, however, that its rule should be inelastically and rigidly applied.

The Court below agreed with the above conclusion, but felt bound by precedent to hold otherwise. We think the Court has unnecessarily restricted itself. If the decision in the precedent is erroneous, it may and should be overruled. Furthermore, it is our contention the precedent upon which the Court below impinged itself is clearly not in point. It therefore follows that the rule set forth by the First Circuit in the *Boston Consolidated Gas Company Case,* being the only appellate case in point, should be followed by this Honorable Court in deciding in favor of appellant herein.

In the case of *Stevenson-Chislett, Inc. v. The United States,* which is reported in 98 Fed. Supp., 252, and which case is now pending in this Court, Judge Clary, in the District Court for the Western District of Pennsylvania, held that the taxpayer was entitled to deduct the embezzlement losses in the year of discovery where the embezzlements took place in previous years but were not known to the taxpayer. We submit to the Court that the decision is correct, but contend most earnestly that there can be no distinction between that case and the instant case merely because of the fact that the taxpayer there was unable to discover the exact year of losses because the embezzler did not keep any records, where here the embezzler kept a record of what he had appropriated but which fact was entirely unknown to the taxpayer. In both cases, the deduction should be allowed in the year of discovery.

In the recent case of *Rutkin, Petitioner, v. United States of America,* decided March 24, 1952, and reported in Law. Ed. Advance Reports for April 7, 1952, Vol. 96, page 485, this Court has approved the principles involved

in *Commissioner v. Wilcox, supra*; which held that embezzled funds were not taxable income to the embezzler on the theory that the embezzler had no *bona fide* legal or equitable claim to the money, was under a definite legal obligation to return it to its rightful owner and consequently had no more received the kind of "gain" or "income" which Congress has taxed than if he had merely borrowed money. To be consistent and to follow that decision to its logical conclusion, it is clear that no loss by embezzlement could be held to be sustained until, upon discovery thereof, and the happening of contemporaneous events, such as here, the death of the insolvent embezzler, has made recovery of the "loan" impossible.

In view of the facts in this case and the law applicable thereto, as set forth above, it is respectfully urged that the Court conclude as a matter of law that appellant, Martha L. Alison, sustained a deductible loss of $21,804.90 during the year 1941, and that by reason thereof the judgment of the Court below be reversed and set aside and judgment here entered in her favor and against the defendant below in the amount of $2,843.78, with interest at six per cent (6%) on $2,711.78 from March 11, 1942, and on $132.00 from November 19, 1942.

Respectfully submitted,

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Nos. 79 and 80

In the Supreme Court of the United States

OCTOBER TERM, 1952

MARTHA L. ALISON

v.

THE UNITED STATES OF AMERICA

THE UNITED STATES OF AMERICA

v.

STEVENSON-CHISLETT, INC.

On Certificates from the United States Court of Appeals for the Third Circuit

BRIEF FOR THE UNITED STATES

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In the Supreme Court of the United States

OCTOBER TERM, 1952

No. 79

MARTHA L. ALISON

v.

THE UNITED STATES OF AMERICA

No. 80

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v.

STEVENSON-CHISLETT, INC.

On Certificates from the United States Court of Appeals for the Third Circuit

---

BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The opinion of the District Court in *Alison* v. *United States* (No. 79) (R. 5-8) is reported at 97 F. Supp. 959. The opinion of the District Court in *United States* v. *Stevenson-Chislett, Inc.* (No. 80) (R. 3a-11a) is reported at 98 F. Supp. 252. The Court of Appeals did not issue an opinion.

JURISDICTION

The Court of Appeals certified questions of law on which it desired instructions. The certificate in the *Alison* case (No. 79, R. 8-11) was filed on May 3, 1952. The certificate in the *Stevenson-Chislett* case (No. 80, R. 13-16) was filed on May 23, 1952. On June 9, 1952, orders were entered by this Court requiring the entire record in each case to be sent up so that the entire matters in controversy might be decided. (No. 79, R. 11; No. 80, R. 16.) The jurisdiction of this Court is conferred by 28 U.S.C., Sec. 1254 (3).

QUESTIONS PRESENTED

1. In the *Alison* case the taxpayer discovered in 1941 that she had suffered embezzlements over a period of prior years. When the embezzlements were discovered, the statute of limitations prevented the filing of refund claims for some, but not all of the taxable years in which the embezzlements had occurred.

The question is whether, notwithstanding the fact that no embezzlement took place in 1941, the taxpayer can be allowed under Code Section 23 (e) to deduct in her income tax return for that year the entire net amount embezzled in previous years.

2. In the *Stevenson-Chislett* case, the taxpayer discovered in 1945 that it had suffered embezzlements over a period of prior years. The precise years in which the embezzlements took place were not known and, as found by the District Court, it was a practical impossibility to ascertain that fact.

The question is whether, notwithstanding the fact that no embezzlement took place in 1945, the taxpayer can be allowed under Code Section 23 (f) to deduct in its income tax return for that year the entire net amount embezzled in previous years.

STATUTE AND REGULATIONS INVOLVED

The applicable provisions of the statute and regulations involved are set forth in Appendix A, *infra*, pp. 54-58.

STATEMENT

ALISON CASE

In the *Alison* case the facts were stipulated (R. 2-4), and were found by the District Court in accordance with the stipulation (R. 5-6). The pertinent facts may be summarized as follows:

The taxpayer, the owner of certain real estate and securities, had entrusted control and possession of the property to J. W. Cree, who acted as her business agent and adviser. There was no written agreement between the taxpayer and Cree with regard to this property, and no accounting was ever requested of or given by him. The taxpayer's account, as well as that of other persons, was carried in a separate set of books called the "J. W. Cree, Jr., Trust Account," the funds of which were commingled with his personal funds. The taxpayer's securities were carried in the name of Cree. (R. 3.)

Cree died in 1941. Shortly after Cree's death the taxpayer found that there was due her in cash the sum of $30,155.37, which was not available for payment to her because Cree had commingled the funds with his own and had used them for his personal benefit. The taxpayer was the largest creditor of Cree's estate. Since the estate did not possess sufficient funds to satisfy all creditors, an agreement was reached as a result of which the taxpayer incurred a net loss of $21,804.90. Pursuant to the agreement, she received a cash payment of $3,380.95 in 1942 from a creditor of Cree's estate. (R. 3.)

The amounts taken by Cree and the amounts paid back, as shown by Cree's books, are as follows (R. 4):

Years	Amount Taken	Amount Paid Back	Net Amount Embezzled
1931	$ 8,000.00	$ 2,000.00	$ 6,000.00
1932	500.00	----	500.00
1934	2,000.00	----	2,000.00
1935	3,000.00	----	3,000.00
1936	4,800.00	500.00	4,300.00
1937	2,000.00	----	2,000.00
1938	4,950.00	1,450.00	3,500.00
1939	4,300.00	----	4,300.00
1940	1,500.00	----	1,500.00
1941	----	----	----
	$31,050.00	$ 3,950.00	$27,100.00
Add: "Uninvested principal in principal (stock) Acc't			3,055.37
Total uninvested cash embezzled			$30,155.37

During this period, Cree enjoyed substantial credit and had a reputation for meeting his bills. The taxpayer had no reason to suspect that her funds were being embezzled by Cree and she had

no knowledge of the embezzlements until after his death. (R. 4.)

The taxpayer, claiming an additional deduction on account of the $21,804.90, filed a refund claim for 1941 (R. 2). The Commissioner rejected the claim on the ground that the loss was due to embezzlements attributable to the years 1931 to 1940, and did not occur in 1941 (R. 3). The District Court, in the taxpayer's suit for refund, held that the deduction was not allowable in 1941 (R. 6-8). The Court of Appeals, after hearing the case, ordered a rehearing before the court *en banc*. The six judges who heard the case were equally divided on the issue and certified the question to this Court which, thereafter, ordered that the entire record be sent up. (R. 10-11.)

STEVENSON-CHISLETT CASE

In the *Stevenson-Chislett* case the following facts, based on the pleadings and proof, were found by the District Court:

In the early part of 1945, during an audit of the books of the taxpayer corporation, a discrepancy was discovered between the accounts receivable control account in the general ledger and the total of the individual accounts receivable as of December 31, 1944. Further investigation established the exact amount of the discrepancy as being $21,675.37. (R. 4a.)

This amount represented funds embezzled from the taxpayer by an unknown person or persons over an unascertained number of prior years. The taxpayer's cashier-bookkeeper over a period of several years had been manipulating the books and records to cover up cash shortages. This was done by accumulating for several months credit slips of individual accounts receivable. Credit slips were posted in later months, but there were usually several months of credit slips unposted. These manipulations were aided by an officer of the corporation. This, together with the silence of other employees who knew of or suspected the manipulations, resulted in the taxpayer's failure to discover the shortage until 1945. (R. 4a.)

The District Court concluded that the series of embezzlements, the nature of the records available, and the reluctance of the persons involved or suspected to render cooperation, made it a practical impossibility for the taxpayer to ascertain the exact year or years in which the succession of shortages occurred. It also concluded that an attempt to segregate the exact year or years of the shortages would have required a very detailed and extensive audit, and investigation, with no assurance that it would be successful, and that the taxpayer had made a reasonable effort to ascertain the dates of the embezzlement and the identity of the guilty party. (R. 5a.)

The taxpayer filed a refund claim for the calendar year 1945 asserting the right to deduct in that year the amount of $20,925.20 on account of an embezzlement loss which had been discovered in that year. After the Commissioner failed to grant the claim, a suit for refund was instituted in the District Court. (R. 3a-4a.) The District Court held that, although embezzlements had taken place in prior years, the loss was deductible in 1945 when discovered (R. 5a-11a). The Court of Appeals, after hearing the case, ordered a rehearing before the court *en banc*. The six judges who heard the case were equally divided on the issue and certified the question to this Court which, thereafter, ordered that the entire record be sent up. (R. 13-16.)

SUMMARY OF ARGUMENT

A. Code Section 23 (e) and (f) grants a deduction for losses sustained during the taxable year. From a very early time this has been administratively construed to mean, in the case of embezzlement losses, that such losses are sustained and are deductible in the year in which the embezzlement occurs. A long line of judicial decisions over the course of years has confirmed this interpretation.

The year in which an embezzlement loss is discovered is not the year in which the loss is sustained. Even though the discovery is too late to permit the filing of amended returns for claiming the loss in the year in which sustained by the

embezzlement, or even though it is difficult or impossible to ascertain the exact year of the embezzlement, there is no statutory authority under which the earlier loss can be deducted in the later year when the discovery is made.

B. Code Section 43 does not constitute a statutory authorization for permitting an embezzlement loss to be deducted in a taxable year subsequent to the year in which the loss was sustained. That section, which is concerned with a clear reflection of income, was never intended to permit the deductions of one year to be taken in another year simply because the annual accounting system is considered to result in harsh consequences to a particular taxpayer, such as when the right to the deduction is not discovered until the statute of limitations bars the deduction for the proper year, or when it is difficult to ascertain the proper year for the deduction. Indeed, since the deduction of the losses of prior years' embezzlements in the discovery year does not result in a clear reflection of that year's income, and since the aggregation of several years' losses as a deduction in a single tax year is bound to result in a distortion of income, it would subvert the function of Section 43 if it were applied to such use.

C. The Treasury Regulations which interpret Code Section 43 do not permit an embezzlement deduction to be taken in the discovery year. While

the Regulations state that an embezzlement loss is "ordinarily" deductible in the year when the embezzlement is sustained, the word "ordinarily", when analyzed in the context of the history of the Regulations, does not imply that the loss may be deducted in the discovery year. The provisions of the Regulations as a whole and their administrative interpretation preclude any other conclusion. Further, since Code Section 43, which the Regulations interpret, is designed to achieve a clear reflection of income, it is plain that the Regulations were not intended to permit a distortion of income by allowing the deduction to be taken in an improper year.

D. The fact that Congress has acted to mitigate the statute of limitations in certain limited circumstances which are not applicable here illustrates why the statute of limitations cannot be circumvented by permitting embezzlement losses of barred years to be deducted in the discovery year. Further, the fact that Congress, motivated by difficulties confronting taxpayers in establishing the exact year of a loss, acted to create a conclusive, statutory presumption regarding the time when certain war losses were sustained, illustrates why difficulty of proof in other circumstances does not constitute a valid reason for permitting a loss deduction to be taken in a year when the loss was not sustained. These legislative enactments demonstrate why the particular hardships of which these

taxpayers complain present problems which are properly addressed to Congress for its consideration.

ARGUMENT

Embezzlement Losses Must Be Deducted in the Year When the Embezzlement Occurs. The Deductions Cannot Be Allowed in a Year When No Loss Was Sustained

The question presented by the *Alison* case (No. 79) is whether the taxpayer is entitled to a loss deduction under Section 23 (e), Internal Revenue Code (Appendix A, *infra*, p. 54), for the taxable year 1941, that being the year in which it was discovered that she had suffered embezzlements during a period of years, all of which were prior to the taxable year. We believe that the question should be answered "no."

The question presented by the *Stevenson-Chislett* case (No. 80), is whether the taxpayer is entitled to a similar deduction under Code Section 23 (f) for the taxable year 1945, that being the year in which it was discovered that the taxpayer had suffered embezzlements during a period of prior years, although the actual years of the embezzlements were unknown and it was a practical impossibility to ascertain them. We believe that this question should also be answered "no."

In both cases the embezzlements took place in prior taxable periods and no losses were sustained in the years in which the loss deductions are being claimed. Because, as we view the

matter, the same basic principles are dispositive of both of these cases and require that the claimed deductions should not be allowed in the taxable years, it seems appropriate that the cases be examined together in a single brief.

A. Code Section 23 (e) and (f) Requires That An Embezzlement Loss Be Deducted Only In the Year When the Embezzlement Occurs.

The decision of these cases must turn on the proper construction of the statute; accordingly, we begin with the language by which Congress has conferred the right to the deduction. Code Section 23 (e) grants to individual taxpayers the right to a deduction for certain kinds of specified "losses";[1] Section 23(e)(3) (Appendix A, *infra*, p. 54), enumerates, as one of the deductible losses, those arising from "theft," a term which has been construed to include losses from embezzlements. Section 23(f) (Appendix A, *infra*, p. 54), grants to corporate taxpayers a deduction for "losses," without limitation on the nature of the loss or the manner in which incurred.[2] Congress has specified precisely when the deduction is to be taken by individual and corporate taxpayers, for each subsection applies only to "losses sustained during the taxable year."

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[1] The taxpayer in the *Alison* case is an individual, so that Section 23(e) is applicable.

[2] The taxpayer in the *Stevenson-Chislett* case is a corporation, so that Section 23(f) is applicable.

The language of Section 23 is unambiguous; it permits the deduction to be taken *only* in the year when the loss is actually sustained, and necessarily forbids the deduction from being taken in any other taxable period. Commenting on these plain words of the statute in *Boehm* v. *Commissioner*, 326 U. S. 287, 292, this Court said: "Such unmistakable phraseology compels the conclusion that a loss, to be deductible under Section 23(e), must have been sustained *in fact* during the taxable year."

Since the only operative event which took place within the taxable year in each of these cases was the taxpayer's discovery of the net amount of the embezzlement losses which had occurred in prior years, it seems inescapable that no loss has "been sustained *in fact* during the taxable year." The statute, accordingly, precludes the taxpayers from being entitled to the claimed deduction in these discovery years since they are not the loss years. There is nothing, moreover, in Section 23 or in any other section of the Code which authorizes the deduction to be shifted from the year in which the loss was sustained to the year in which discovered, or to any other year, simply because the discovery was too late to permit the deduction to be claimed in the proper taxable period, as is true of some of the years involved in *Alison*, or because the precise years of the losses may be difficult to ascertain, as is the situation in *Stevenson-Chislett*.

The history of the statute and its construction from an early date fully substantiate these conclusions. A deduction for certain losses "actually sustained" during the taxable year was provided for individual taxpayers in Section II B, and for corporate taxpayers in Section II G (b) of the Income Tax Act of 1913, c. 16, 38 Stat. 114.[3] This provision was expanded in Section 5 (a), Fourth, of the Revenue Act of 1916, c. 463, 39 Stat. 756, to include, for individual taxpayers, a specific reference to losses from "theft"—and such losses have continued to constitute grounds for deduction in all subsequent income tax enactments. As early as 1919, in O-845, 1 Cum. Bull. 118, it was ruled that embezzlement losses were "sustained" and deductible in the years when they occurred and not in the later year of discovery. The ruling relied on an unreported decision in *United States* v. *Cleveland, Cincinnati, Chicago & St. Louis Railway Co.*, decided on February 23, 1916 (S.D. Ohio),[4] where embezzlements taking place during several prior years were discovered in 1909 and

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[3] Provisions for loss deductions and the requirement that they be taken in the year when the loss was sustained can be traced to Section 13, Act of March 2, 1867, c. 169, 14 Stat. 471. A similar deduction for certain losses "sustained" during the year appears in Section 28, Act of August 27, 1894, c. 349, 28 Stat. 509, and in Section 38, Corporation Excise Tax Act of 1909, c. 6, 36 Stat. 11, 112.

[4] That case was also cited and relied on in *Bentley* v. *Commissioner*, 5 B.T.A. 314, 323; *Peterson Linotyping Co.* v. *Commissioner*, 10 B.T.A. 542, 544.

where the taxpayer claimed a deduction under the Corporation Excise Tax Act of 1909, c. 6, 36 Stat. 11, 112-118, which also granted deductions for losses actually sustained within the taxable year. The court is said to have disallowed the deduction and to have stated (p. 119):

> The time of the discovery of a loss bears no relation to the date the loss was sustained. The loss was sustained when the theft occurred, although the defendant did not know at the time of the depletion of its assets. As each embezzlement occurred, the defendant was poorer to the extent of it. It then sustained a loss. One of the definitions of "sustained" is "undergo." As each embezzlement occurred, the defendant underwent the loss of that much money. It is clear that the defendant is not entitled to the deduction claimed.

Similarly, in I. T. 1470, I-2 Cum. Bull. 60 (1922), it was ruled that the loss "is allowable as a deduction from gross income for the year or years in which the funds were so converted * * *." See also A.R.R. 2503, II-2 Cum. Bull. 131 (1923). This interpretation was noted by this Court in *Burnett* v. *Huff*, 288 U. S. 156, 159, where it was said:

> The Government concedes that if assets of the taxpayer used in trade or business, or "in

> any transaction entered into for profit," are stolen in any year, the taxpayer sustains the loss in that year and the deduction must then be taken even though the theft is not discovered or the amount ascertained until the following year. * * *

The decided cases, with complete uniformity until 1942, have ruled that an embezzlement loss is "sustained" and is deductible only in the year when the embezzlement occurs, regardless of when the loss is discovered. *First Nat. Bank of Skaron, Pa.* v. *Heiner*, 66 F. 2d 925 (C.A. 3d); *Montgomery* v. *United States* (N.D. Ala.), decided September 27, 1932 (15 A.F.T.R. 865); *Rahr Malting Co.* v. *United States*, 54 F. Supp. 282 (E.D. Wisc.), affirmed on other points, 145 F. 2d 867 (C.A. 7th); *Bentley* v. *Commissioner*, 5 B.T.A. 314; *National Sash & Door Co.* v. *Commissioner*, 5 B.T.A. 931; *Peterson Linotyping Co.* v. *Commissioner*, 10 B.T.A. 542; *Gottlieb Realty Co.* v. *Commissioner*, 28 B.T.A. 418; *Piggly Wiggly Corp.* v. *Commissioner*, 28 B.T.A. 412; *Alabama Mineral Land Co.* v. *Commissioner*, 28 B.T.A. 586; *Grenada Bank* v. *Commissioner*, 32 B.T.A. 1290; *Burke Grain Co.* v. *Commissioner*, 39 B.T.A. 334; *Miglietta* v. *Commissioner*, decided January 28, 1943 (1943 P-H T.C. Memorandum Decisions, par. 43,045). Accord: *Borden* v. *Commissioner*, 101 F. 2d 44 (C.A. 2d), and *Simons* v. *Commissioner*, 1 B.T.A.

351 (losses from thefts deductible in years of theft and not in later years when first discovered). See *Piedmont Grocery Co.* v. *United States,* 66 C. Cls. 468, certiorari denied, 280 U. S. 554.

First Nat. Bank of Sharon, Pa. v. *Heiner* and *Montgomery* v. *United States, supra,* like the *Alison* case under review, involved situations where embezzlements were discovered after the statute of limitations had run so that it was too late to permit the deduction to be claimed by the filing of amended returns for the year of the loss. It was held, nonetheless, that the loss could not be deducted in the year when discovered.

The contrary result was reached in *Boston Consol. Gas Co.* v. *Commissioner,* 128 F. 2d 473 (C.A. 1st), although the court there recognized that Section 23 required the loss to be deducted in the year of the embezzlement. This case is discussed under Point B, pp. 18-21, and under Point C, pp. 32, 37-38, *infra,* as the majority of the court based its decision upon the supposed exception under Code Section 43 and the Treasury Regulations issued thereunder.

So far as Section 23 is concerned, we deem it undeniable that that section requires an embezzlement loss to be deducted in the year of the embezzlement and precludes the deduction from being allowed in any other taxable period. The clear language of that section which, from the very beginning, has always specified that the loss be taken in the year when sustained, and which has been

fortified by a long history of administrative construction and judicial decisions on this point, can leave no room for serious dispute of this proposition.[5] Accordingly, if, under exceptional circumstances, the loss deduction can be taken in some other year, such as the year of discovery, and if the present cases represent such an exception, the authority to allow the deduction must be found somewhere other than in Section 23.

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[5] In his concurring opinion in *Boston Consol. Gas Co.* v. *Commissioner*, 128 F. 2d 473, 476-477 (C. A. 1st), Judge Magruder, influenced by the lack of taxable gain to the embezzler, attempted to justify the result of the decision there on the ground that an embezzlement loss was peculiar and was "sustained" within the meaning of Section 23(f), not when the embezzlement took place, but rather when the victim ascertained that he could not obtain complete reimbursement from the wrongdoer.

While this reasoning is fundamentally faulty, the short and conclusive answer is that Section 23(e) and (f) has always been interpreted to mean that an embezzlement loss is "sustained" when the embezzlement takes place. The repeated reenactment of the statute demonstrates that Congress intended that the word "sustained" be so interpreted. Further, if Judge Magruder's reasoning were followed, it would result in the conclusion that no embezzlement loss is deductible in the year when the embezzlement occurs unless, coincidentally, the victim ascertains at that time that he cannot be made whole. This, of course, would be contrary to the consistent course of interpretations and decisions.

The subsequent decision of this Court in *Commissioner* v. *Wilcox*, 327 U. S. 404, also demonstrates why the lack of taxable gain to the embezzler has no bearing on the time of the deduction, for it was there pointed out (p. 409) that there is no "necessarily corresponding relationship" between the taxable gains of the embezzler and the deductions afforded by Congress to the victim.

B. Code Section 43 Does Not Permit an Embezzlement Loss Deduction to be Shifted From the Year When the Loss is Sustained to the Year When Discovered. It is Not Material That the Deduction for the Loss Years is Barred by Limitations, Nor is it Material That the Loss Years are Unascertainable.

The only judicial decision (other than the decision on review in the *Stevenson-Chislett* case) which purports to find authority for an exceptional treatment of embezzlement losses is *Boston Consol. Gas Co.* v. *Commissioner,* 128 F. 2d 473 (C.A. 1st).[6] That decision, however, is erroneous and cannot be accepted as a valid precedent.

In that case the taxpayer, on the death of its treasurer in 1935, discovered a large cash shortage which appeared to have been due to prior embezzlements. In the annual audit made in 1934 for the preceding year, no such cash shortage had been disclosed. After adjustments had been made for amounts recovered from a bonding company and from the deceased treasurer's "beneficiaries," the taxpayer deducted the net loss in its 1935 return. The Board of Tax Appeals, following a previous line of authority from which there had been no deviation, held with the Commissioner that only the net amount actually embezzled in 1935 was deductible in that year. 44 B.T.A. 793. The Court of Appeals, however, reversed. The statutory requirement that the loss be deducted in the year when sustained, the Court said, was to prevent a

[6] The Tax Court attempted to follow this decision as part of its rationale in *Gwinn Bros. & Co.* v. *Commissioner,* 7 T. C. 320 (acquiescence in result only, 1946-2 Cum. Bull. 2).

taxpayer from making his own selection of the year in which the deduction would be claimed. But it said (p. 476)—

> we believe that Congress did not intend that its rule should be inelastically and rigidly applied, and this we think the Treasury Department recognized when it used the word "ordinarily" in the last sentence of Article 43-2 of its Regulations 86.

The court observed that usually where the embezzlement was discovered in a later year, an amended return could be filed for the year of the loss. However, because it was thought that the taxpayer in that case (p. 476) was "unable to determine the actual dates of the different acts of embezzlement,"[7] the Court concluded that the (*ibid.*) "situation is so extraordinary that its total net loss may be deducted in the year when the loss was discovered and its extent determined * * *."

The Court of Appeals, it should be noted, did not rule that the loss was "sustained" in 1935 or deny that it was "sustained" in the years when the embezzlements took place, within the meaning of

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[7] The record in the *Boston Consol. Gas Co.* case does not justify this factual conclusion by the Court of Appeals. Aside from the inferences to be drawn from the agreed fact that the 1934 audit did not disclose the cash shortage, there is nothing in the stipulated facts, on the basis of which the case was tried, to the effect that the taxpayer was unable or would find it difficult to determine the exact years of the embezzlement.

Section 23(f) of the Revenue Act of 1934, c. 277, 48 Stat. 680. Nor did the court purport to find in Section 23(f) any exception for extraordinary situations. Instead, the decision is clear in holding that authority for an exception was to be found in the Treasury Regulations construing Section 43 of the 1934 Act. The court's conclusion that the circumstances of that case fell within a supposed exception was its own, and is unsupported by any precedent.[8] As will be seen, Section 43 (Appendix A, *infra*, p. 55) and the cognate Treasury Regulations do not sanction such a deviation regarding the time when embezzlement losses are to be deducted.

Code Section 43 provides that deductions and credits shall be taken in the taxable year in which "paid or accrued" or "paid or incurred" in accordance with the taxpayer's method of accounting "unless in order to clearly reflect the income the deductions or credits should be taken as of a different period." This language, however, does not create an exception of the kind applied in the *Boston Consol. Gas Co.* case and which the tax-

[8] *Glenn* v. *Louisville Trust Co.*, 124 F. 2d 418 (C. A. 6th), which the court recognized as not being squarely in point, but which it relied on as indicating the proper view of the statute, held that a loss resulting from the compromise of a disputed claim against a fiduciary for an unauthorized, improper investment was sustained and deductible in the year when the claim was settled. It had nothing to do with an undisputed embezzlement loss or the year in which such a loss would be sustained.

payers seek to invoke in the circumstances of the present cases. Thus, in *Security Mills Co.* v. *Commissioner*, 321 U. S. 281, the taxpayer similarly attempted to invoke the "unless" clause of Section 43 as an exception to the annual accounting rule in circumstances where it was claimed that it would be "unjust or unfair" not to do so. This Court, after examining the history of Section 43, rejected the contention that it granted discretionary authority to prevent unjust results. The opinion, speaking of Section 43, stated (pp. 285-286)—

> it is clear that the purpose of inserting the qualifying clause was to take care of fixed liabilities payable in fixed installments over a series of years. * * * But we think it was not intended to upset the well-understood and consistently applied doctrine that cash receipts or matured accounts due on the one hand, and cash payments or accrued definite obligations on the other, should not be taken out of the annual accounting system and, for the benefit of the Government or the taxpayer, treated on a basis which is neither a cash basis nor an accrual basis, because so to do would, in a given instance, work a supposedly more equitable result to the Government or to the taxpayer.

The history of Section 43 fully confirms the correctness of the ruling in the *Security Mills Co.* case and demonstrates that that section does not confer upon taxpayers the right to claim a loss deduction in a year when no loss was in fact sustained. The "unless" clause had its origin in Sections 214(a)(6) and 234(a)(4) of the Revenue Act of 1921, c. 136, 42 Stat. 227, which, as was true of prior enactments, provided that all losses (not merely those arising from theft) should be deducted in the year in which sustained, and which added—"unless, in order to clearly reflect the income, the loss should, in the opinion of the Commissioner, be accounted for as of a different period" In explanation of this, the Senate Committee on Finance stated (S. Rep. No. 275, 67th Cong., 1st Sess., pp. 14-15 (1939-1 Cum. Bull. (Part 2) 181, 191)—

> losses occurring in one year are frequently not determined or sustained until another year, depending upon court decision or the clearing up of uncertainty. To permit more elastic treatment of such losses, in the interests of justice to the taxpayer, it is provided that certain losses shall not be deducted as of the taxable year in which sustained, if in the opinion of the commissioner they should be accounted for as of a different period; * * *

Since the committee was concerned with the tax treatment of losses when there was some uncertainty concerning the rights of the taxpayer which became clarified in a subsequent year, and since the standard on which the Commissioner was to act in exercising his discretion to require a clear reflection of income was somewhat vague, at least as it was stated by the committee, it was evidently difficult to carry out the embryonic policy embodied in these sections. The Commissioner did his best to comply. Thus, in Treasury Regulations 62, promulgated under the 1921 Act, Article 111 provided that—"A loss from theft or embezzlement occurring in one year and discovered in another is ordinarily deductible for the year in which sustained." The prior Regulations had provided that the loss was deductible "only" for the year in which sustained.[9] Article 146 of Treasury Regulations 62, to which Article 111 made a cross-reference, stated the general rule to be that losses were to be deducted in the year when sustained. Calling attention to the Commissioner's authority to permit the deduction to be taken in another year in order to avoid injustice to the taxpayer and to reflect income more clearly, Article 146 continued by saying "For example, an embezzlement or a shipwreck may occur in 1921 but not become known until 1922 and in such a

[9] Art. 111, Treasury Regulations 45, promulgated under the Revenue Act of 1918.

case income may be more clearly reflected by accounting for the loss as of 1922 rather than 1921." If a taxpayer desired to account for a loss as of a different period than the year in which sustained, the Regulations required a complete statement of the facts, but provided that in his tax return "he shall deduct the loss only for the taxable year in which actually sustained;" the Commissioner, upon the basis of the taxpayer's statement, would decide whether the circumstances fell within the exception of the statute, and if not, the loss would be allowed only for the taxable year in which sustained. It was made clear, moreover, that "The allowance of a deduction for a loss in a year other than the one in which sustained is entirely within the discretion of the Commissioner and he will consider exercising this descretion only in exceptional cases."

We may pause at the 1921 Act to observe that, vague as were the standards for the exercise of the Commissioner's discretion, there was no evident notion that a loss should be deductible during a different year merely because it was discovered after the statute of limitations prevented a deduction for the year of the occurrence of the loss. The committee report illustrated situations where uncertainties were cleared up during subsequent years, and did not deal with any mitigation of the statute of limitations or with an inability to ascertain the year of the loss. And,

while the Regulations did not specify the circumstances in which the Commissioner would exercise his discretion to achieve a clear reflection of income, there was no intimation that a distortion of income requiring correction would result from the running of the statute of limitations or from a practical inability to determine the year of the loss, for the example given in the Regulations was one where the year of the loss was known and where the discovery was made in the year immediately after the loss was sustained.

We have been unable to discover any situation in which the Commissioner exercised his discretion under the 1921 Act to permit an embezzlement loss to be deducted in a year other than that in which the embezzlement took place In *Simons* v. *Commissioner*, 1 B.T.A. 351, a theft occurring in 1921 was not discovered until 1922. The Board, referring to these provisions of the 1921 Act, approved the Commissioner's determination that income was clearly reflected by requiring the deduction to be taken in 1921. The decision demonstrates, at the least, that, notwithstanding the illustration in the example of the Regulations, the Commissioner was not exercising his discretion to shift the year of the deduction merely because the loss was discovered in a subsequent year.

The statutory pattern was again altered by the Revenue Act of 1924, c. 234, 43 Stat. 253. Under Sections 214(a)(4), (5), and (6) and 234(a)(4),

as was true prior to the 1921 Act, losses were to be deducted in the year when "sustained," without any qualification being stated in those sections. This has been the statutory rule set forth in every subsequent enactment.[10] The 1924 Act added, as a new provision, Section 200(d), the predecessor of Code Section 43, which provided that deductions should be taken in the taxable year in which "paid or accrued" or "paid or incurred," dependent on the method of accounting employed by the taxpayer, "unless in order to clearly reflect the income the deductions or credits should be taken as of a different period." The quoted language has appeared in all subsequent statutes.[11]

The committee explanation of this exception demonstrates a more mature appreciation of what is involved in the concept of a clear reflection of income and shows, as was held in the *Security Mills* case (321 U. S. 281), that it was not intended that deductions should be taken in other years to avoid what a particular taxpayer regards as an unjust or burdensome consequence of the annual

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[10] Sections 214(a)(4), (5), and (6), and 234(a)(4), Revenue Act of 1926 (c. 27, 44 Stat. 9); Section 23(e) and (f), Revenue Acts of 1928 (c. 852, 45 Stat. 791), 1932 (c. 209, 47 Stat. 169), 1934 (c. 277, 48 Stat. 680), 1936 (c. 690, 49 Stat. 1648), 1938 (c. 289, 52 Stat. 447), and of the Internal Revenue Code.

[11] Section 200(d), Revenue Act of 1926; Section 43 of the Revenue Acts of 1928, 1932, 1934, 1936, 1938, and of the Internal Revenue Code.

accounting system. The Committee on Ways and Means (H. Rep. No. 179, 68th Cong., 1st Sess., pp. 10-11 (1939-1 Cum. Bull. (Part 2) 241, 249)), explaining Section 200(d), stated:

> (2) In subdivision (d) of this section authority is granted to the Commissioner to allow or require deductions and credits to be taken as of a year other than that in which "paid" or "accrued" when, in his opinion, it is necessary in order to clearly reflect the income. The Revenue Act of 1921 in sections 214(a)(6) and 234(a)(4) authorizes the Commissioner to allow the deduction of losses in a year other than that in which sustained when, in his opinion, it is necessary to clearly reflect the income. The proposed bill extends that theory to all deductions and credits. The necessity for such a provision arises in cases in which a taxpayer pays in one year interest or rental payments or other items for a period of years. If he is forced to deduct the amount in the year in which paid, it may result in a distortion of his income which will cause him to pay either more or less taxes than he properly should.

The same explanation is given in S. Rep. No. 398, 68th Cong., 1st Sess., pp. 10-11 (1939-1 Cum. Bull. (Part 2) 266/273).

The purpose to be served by the "unless" clause of Section 43 and its predecessors is "to clearly reflect the income" of the taxpayer. As the *Security Mills* case makes plain, it is the income of the taxable year, measured in relationship to the statutory principle of an annual accounting, which is to be reflected clearly. Such a goal, far from being achieved, would be subverted if, for example, the taxpayer in *Alison* were permitted to deduct in one year the total amount of the net losses which were sustained during a period of nine previous years. Since there was no embezzlement loss in 1941, and since nothing else occurred in that year which would affect the amount of net income earned in 1941, it is difficult to comprehend how there can be a clear reflection of 1941 income if the taxpayer is permitted to take the entire amount, or even any part of the prior years' losses as a deduction in the year 1941. To permit the losses of other years to be deducted in that year not only disturbs the annual accounting system (cf. *United States* v. *Lewis*, 340 U. S. 590, 592; *Burnet* v. *Sanford & Brooks Co.*, 282 U. S. 359, 363), with which Section 43 does not interfere (*Security Mills Co.* v. *Commissioner, supra*, pp. 286-287), but the accumulation of nine years' losses as a single deduction in a single tax year can only result in a distortion of the taxpayer's 1941 income, contrary to the very purpose of Sec-

tion 43.[12] The same observations are equally true of the *Stevenson-Chislett* case.

Section 43 is given its proper scope when applied in the general kind of circumstances described in the Committee Reports and in the *Security Mills* case, *supra*, where the Court said (p. 285):

> For example, a tenant would not be compelled to accrue, in the first year of a lease, the rental liability covering the entire term nor would he be permitted, if he saw fit to pay all the rent in advance, to deduct the whole payment as an expense of the current year.

There are other situations, too, where items which are paid or accrued in one year actually represent the expenses of other years. In all these circumstances the usual accounting method of a taxpayer, when strictly followed, might result in distortions of income, and the shifting of the deduction to other years is necessary to achieve a clear reflection of income. As we have seen, no such situation is presented by either of these cases.

Further, it is to be doubted whether Code Section 43 has any application to deductions for losses, whether due to embezzlement or other causes. It states the general rule to be that deductions and credits should be taken in the year

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[12] The clear reflection of income is the objective not only of Section 43 but also of the other accounting sections. See Code Sections 41 and 45.

when "paid or accrued" or "paid or incurred," and Code Section 48(c) defines those terms in relation to the method of accounting employed by a taxpayer, i.e., cash or accrual. There are numerous allowances where the year of deductibility depends on the taxpayer's method of accounting, for the statute permits them to be taken when "paid" or "incurred" or "accrued." See Section 23(a)(1) and (2), (b), (c)(1), (cc), and (ff). Both the rule of Section 43 and the exception of the "unless" clause are geared to deductions of this kind.

Congress, however, has granted other deductions by specifying when they are to be taken, and as to these the taxpayer's method of accounting is not determinative. For example, Section 23(o), in the case of an individual, and Section 23(q), in the case of a corporation, specifies that a charitable deduction should be taken in the year of payment.[13] Again, under Section 23(k) the general rule is that bad debts are deductible in the taxable year when they become worthless.[14] With respect to those deductions, and others, Congress has required that they be taken in a particular year and

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[13] In the case of a corporation on the accrual basis, the last paragraph of Section 23(q) permits, at the taxpayer's election, the deduction to be taken in the year when the contribution was authorized if it is paid by the 15th day of the third month following the close of the taxable year.

[14] In the discretion of the Commissioner, a taxpayer may deduct a reasonable addition to a reserve for bad debts.

has, in effect, provided a rule for the proper reflection of income having equal application to all methods of accounting. The point is that Section 43, as it states the general rule which permits the taxpayer's accounting system to determine the time when some items are deductible and states the exception which, with respect to the same items, may require a deviation from the usual accounting system when necessary for a clear reflection of income, does not have any application in those instances where the statute itself designates the exact year of the deduction.

These observations are equally applicable to the deduction of embezzlement losses under Section 23(e) and (f). Congress there, too, has required that the deduction be taken in a particular year, namely, the year in which the loss is "sustained." This, as we have shown (pp. 11-17 *supra*), means the year in which the embezzlement occurred. The year in which such a loss is sustained, quite obviously, is not affected by the accounting method employed by a particular taxpayer, for the loss is "sustained" at precisely the same point of time no matter whether the cash or the accrual system is being employed. Or, to use the statutory language, the year in which an embezzlement loss is "sustained" has nothing to do with when an item is "paid or accrued" or "paid or incurred" under Section 43. That section, accordingly, does not purport to state a rule or an exception to a

rule which impinges on Section 23(e) and (f), and it provides no authority for altering the year in which Congress requires that an embezzlement loss be deducted.

C. The Treasury Regulations Do Not Interpret Code Section 43 As a Buffer Against the Statute of Limitations or Against Other Supposed Hardships.

As we have already noted, the decision in *Boston Consol. Gas Co.* v. *Commissioner*, 128 F. 2d 473 (C. A. 1st), permitting the embezzlement loss to be deducted in the year when the loss was discovered rested on the notion that such an exception was contemplated by the governing Treasury Regulations which interpret Section 43. Referring to Article 43-2, Treasury Regulations 86, which provided that "A loss from theft or embezzlement occurring in one year and discovered in another is ordinarily deductible for the year in which sustained," and emphasizing the word "ordinarily," the Court concluded that Congress did not intend that an embezzlement loss should always be deducted in the year when sustained, and held that that case fell within the supposed exception. And the taxpayers in the present cases also contend that their situations fall within the indefinite boundaries of such an exception.

We believe, on the contrary, that the word "ordinarily" in the Treasury Regulations was never intended to serve as a vehicle for circumventing the most elemental principles on which

Congress has constructed the pattern of the income tax statute. Violation of the rule requiring an annual accounting, distortion of a taxpayer's income by permitting the losses of other years to be deducted in a single, non-loss year, disregard of the applicable statute of limitations, and the use of equitable principles to avoid hardships—all this the taxpayers contend was sanctioned by the single word "ordinarily" in the Treasury Regulations. Ironically, the Treasury Regulations are supposed to have accomplished this in the interpretation of Section 43 where Congress acted to insure a clear reflection of income and an adherence to the basic annual accounting system. And the Treasury Regulations are supposed to have placed only embezzlement losses in this peculiarly preferred position.

Actually, the word "ordinarily" cannot be considered to carry such an onerous burden of meaning. The statement that an embezzlement loss is "ordinarily" deductible in the year when sustained first appeared in Article 111, Treasury Regulations 62, which, together with Article 146, attempted to give effect to the vague Congressional policy embodied in Sections 214(a)(6) and 234(a)(4) of the 1921 Act which gave the Commissioner discretionary authority to permit a loss deduction to be taken in a year other than the year in which sustained when that would result in a clear reflection of income. (See pp. 23-25, *supra*.)

When the 1924 Act first adopted Section 200(d), from which Code Section 43 is derived, Article 1523, Treasury Regulations 65, promulgated under that Act, recognized the changed situation not only by the totally different language employed, as compared with Article 146 of Treasury Regulations 62, but by deleting any reference to the example given in Article 146 of Regulations 62 to the effect that an embezzlement may occur in 1921 but not become known until 1922, and that income may be more clearly reflected by accounting for the loss in 1922. Article 112, Treasury Regulations 65, as is true of all corresponding provisions of succeeding Regulations,[15] continued, however, to repeat the sentence in Article 111, Treasury Regulations 62, to the effect that an embezzlement loss is "ordinarily" deductible in the year when sustained.

It cannot be doubted that the Regulations would have been more accurate in reflecting the meaning of the statute if the word "ordinarily" had been deleted after the 1924 Act was adopted. The retention of the word "ordinarily" was apparently

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[15] Article 112, Treasury Regulations 69, promulgated under the Revenue Act of 1926; Article 342, Treasury Regulations 74-75, and 77, promulgated under the Revenue Acts of 1928, and 1932; Article 43-2, Treasury Regulations 86, 94, and 101, promulgated under the Revenue Acts of 1934, 1936, and 1938; Section 19.43-2, Treasury Regulations 103, and Section 29.43-2 Treasury Regulations 111, promulgated under the Internal Revenue Code (Appendix A, *infra*).

an oversight on the part of the original draftsmen, continued in subsequent promulgations more by inertia than by a studied purpose. It represents no more than a vestigial appendix, possessing no purposeful meaning since 1924. More significant than this single, isolated word is the fact that the Regulations as a whole do not support the notion that such an extraordinary treatment of embezzlement losses was intended. This, we submit, is evident from the content of the Regulations adopted under the 1924 Act, and continued in subsequent Regulations. Thus, Article 112 of Regulations 65, in which the "ordinarily" phrase is found, stated:

> The expenses, liabilities, or deficit of one year can not be used to reduce the income of a subsequent year. * * * A taxpayer has the right to deduct all authorized allowances, and it follows that if he does not within any year deduct certain of his expenses, losses, interest, taxes, or other charges, he can not deduct them from the income of the next or any succeeding year. * * *"

The same paragraph also stated that—

> If subsequently to its occurrence, however, a taxpayer first ascertains the amount of a loss sustained during a prior taxable year which has not been deducted from gross income, he may render an amended return for such pre-

> ceding taxable year including such amount of loss in the deductions from gross income and may file a claim for refund of the excess tax paid by reason of the failure to deduct such loss in the original return. See Section 281. * * *[16]

The same language will be found in Section 29.43-2, Treasury Regulations 111, promulgated under the Internal Revenue Code (Appendix A, *infra*, p. 58). There could be no plainer statement of the rule that all deductions must be taken in the proper year, even when the right to the allowance is discovered later. And nowhere in the Regulations is there the slightest indication that there is to be a deviation simply because the rule may be thought to be harsh or oppressive in particular circumstances. Indeed, by requiring that amended returns be filed for the proper year if they are not barred by limitations, the Regulations would seem to preclude the conclusion that the deduction may be taken in the improper year after limitations has run. At least, if there had been any intention to permit the deduction to be taken in the wrong year when the right to the deduction is discovered too late, it would be expected

[16] Section 281 of the 1924 Act, here referred to, contains the authority for refunds and sets forth the period of limitations beyond which such refunds cannot be paid.

that the Regulations would have stated such an important exception in clearer language than the word "ordinarily."

Further, and also more significant than this vague, unexplained word in the Regulations, is the fact that those who are charged with the administration of the law have not interpreted the Regulations to require the results contended for by these taxpayers. We have been unable to discover any published ruling, interpretation, or instruction in which the Commissioner has construed the Regulations to possess such a meaning. And the informal practice by which particular cases of this kind are being handled by individual field offices of the Bureau of Internal Revenue demonstrates that the Regulations are not regarded as requiring the allowance of the deduction in the discovery year. The general practice of these offices appears to be in harmony with what we consider to be the correct application of the statute and the Regulations. While there have been some situations where individual cases, sometimes for settlement purposes, have been disposed of differently, they are in the distinct minority. This informal practice is described in greater detail in a letter from the Commissioner of Internal Revenue dated October 1, 1952, set forth in Appendix B, *infra*.

The court in the *Boston Consol. Gas Co.* case

rested its conclusion on a single word of the Regulations. If, instead, it had examined the history of the statute and the Regulations; if it had appreciated that the Commissioner had not interpreted the Regulations in that manner, and if it had had the benefit of this Court's subsequent decision in *Security Mills Co.* v. *Commissioner*, 321 U. S. 281, respecting the meaning of Section 43, and of the subsequent decision in *Boehm* v. *Commissioner*, 326 U. S. 287, relating to the time for the deduction of losses under Section 23, we believe it would have reached the opposite result.

Finally, even if the word "ordinarily" should be deemed to imply that the Commissioner will permit exceptional treatment in extraordinary situations, it does not follow that the present cases fall within the exception, whatever its boundaries may be. The Commissioner, by refusing to allow the claims for refund in these cases, evidently believed that the income of the taxable years would not be reflected more clearly by permitting the deduction to be taken in these years. Since the ultimate key to the resolution of this conflict must be found in the statute, and since Code Section 43 is concerned only with a clear reflection of a taxpayer's income, the present taxpayers can establish that the Commissioner's action was erroneous only if they demonstrate that their income for the taxable years will be clearly reflected by claiming a deduction at that time for

losses of other years. This, we believe, they cannot successfully do. (See pp. 28-29, *supra*.)[17]

D. If the Year When Embezzlement Losses Are Deductible is to be Shifted to Prevent Hardships, the Matter is One For Congressional Action.

1. The ultimate circumstances on which the taxpayer in *Alison* bases her right to claim the entire deduction in 1941 for embezzlement losses sustained during the years 1931-1940, inclusive, is

[17] Furthermore, Section 29.43-1 of Regulations 111, in dealing with the exception of Section 43 designed to produce a clear reflection of income, makes it plain that a taxpayer cannot lightly assume that the exception applies, for even when a taxpayer believes that income will be clearly reflected by claiming a deduction in a year other than that in which the item was paid or incurred, the Regulations require that the deduction be claimed in the year when paid or incurred, and the taxpayer must submit all the facts to the Commissioner who will advise the taxpayer whether the situation falls within the exception and of the proper year in which the credit is to be taken.

This requirement of the Regulations, which has been in existence for nearly 30 years, is a reasonable and valid one; a taxpayer who fails to comply with its terms is, for that reason alone, not entitled to rely on the exception stated in Section 43 to claim a deduction for a different period than the year in which the item is paid or accrued. *Cassatt* v. *Commissioner*, 137 F. 2d 745, 749 (C. A. 3d).

In the present cases, accordingly, even if the exception of Section 43 could be deemed to have any application to loss deductions from embezzlement, the failure of the taxpayers to follow this requirement of the Regulations, namely, the submission of all facts to the Commissioner to permit him to determine whether the deduction should be taken in a different year, should result in a denial of the deduction in a year other than those in which the losses were sustained.

that the deduction was barred by limitations when the embezzlements were first discovered, so that adherence to the rule that the losses are deductible in the year when sustained would operate to deprive her of the deduction altogether. This argument, we note, could have no application to the losses sustained in 1938 through 1940, for those years were not barred when the losses were discovered in 1941, and the taxpayer could have filed amended returns and a claim for refund with respect to those years, as is required by Section 29.43-2, Treasury Regulations 111 (Appendix A, *infra*, pp. 57-58).

The basic argument, however, assumes not only that the statute permits the year of the deduction to be shifted in extraordinary circumstances, but also that the running of the statute of limitations imposes a hardship which should be alleviated. We have demonstrated that the first assumption is erroneous. We believe, moreover, that the second assumption is ill-founded.

Inequities and hardships which may arise from the running of the statute of limitations, and which affect the Government as well as taxpayers, do not pose problems with which the legislature is unfamiliar. Code Section 3801 represents the extent to which Congress, in a very limited area, has seen fit to provide some measure of mitigation against the effects of the statute of limitations. See Maguire, Surrey, and Traynor, *Section 820 of*

the Revenue Act of 1938, 48 Yale L.J. 509, 719 (1938-1939), for a description of the history and operative scope of the predecessor of Code Section 3801.[18]

Several significant conclusions are evident from the enactment of Code Section 3801. That section is designed to prevent the deduction of the same item or the taxing of the same income more than once, for it is to be applied only where the taxpayer or the Commissioner has taken a position in one year which is inconsistent with that taken

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[18] Section 820 of the Revenue Act of 1938, the predecessor of Code Section 3801, resulted from one of the recommendations made by the Subcommittee of the House Ways and Means Committee, 75th Cong., 3d Sess., on "A Proposed Revision of the Revenue Laws." Its ultimate recommendation was couched in broad terms (p. 79, Recommendation No. 48) —"that there be prepared suitable provisions under which the statute of limitations should be so adjusted as to insure the taxation of income, and the allowance of deductions, in the year to which properly allocable." The specific consideration of this matter by the Subcommittee (pp. 54-55) reveals that the problem to be remedied encompassed a more narrow area than that stated by the general language of the ultimate recommendation. In addition, the statute, as enacted, did not parallel the Subcommittees' recommendations in all respects. See Maguire, Surrey, and Traynor, *Section 820 of the Revenue Act of 1938*, 48 Yale L. J. 509 (1938-1939).

Similar recommendations along the same general lines had been made in 1933 in House Committee Print, Prevention of Tax Avoidance, Preliminary Report of a Subcommittee of the Committee on Ways and Means, 73d Cong., 2d Sess., p. 12. See Tyler and Ohl, *The Revenue Act of 1934*, 83 U. of Pa. L. Rev. 607, 644 (1934-1935).

with respect to the same item in a prior year which would otherwise be barred. The purpose of Section 3801 to open up a barred year only to avoid an inconsistent position by a taxpayer or the Commissioner demonstrates that Congress did not intend that limitations should be disregarded in other situations. Thus, the mere fact that the statute of limitations has run so as to prevent a deduction from being claimed in the proper year, as is true of some of the years in the *Alison* case, is not a sufficient reason to depart from the legislative policy which is inherent in a statute of repose. The fact that Congress enacted Section 3801 also emphasizes the conclusion (Point B, pp. 18-32, *supra*), that Section 43 did not and was not intended to serve as a vehicle for shifting deductions from one year to another for the purpose of avoiding the statute of limitations whenever the courts or the Commissioner believed that it would be "equitable" to do so.

Section 3801 (d), moreover, within its narrow sphere of operation, is designed to determine the tax of the barred year in the same manner as it would have been calculated if the item of deduction had been taken or the item of income had been included in the proper year. Thus, the legislative solution, within this area, is to achieve a correct computation of the tax for the correct year. It does not disturb the basic annual accounting system. This is to be contrasted with the result

contended for by the taxpayer, Alison, under which, without any statutory authorization, she seeks to avoid the statute of limitations by claiming the deductions of barred years in a year which would ordinarily be conceded to be the wrong one, and she would further distort her true income of that year by aggregating in one taxable period the total losses accumulated during nine previous years.

Equally significant as it bears on the problem of the *Alison* case is the amendment made by Section 169 of the Revenue Act of 1942, c. 619, 56 Stat. 798, to Code Section 322 (b)(2). That section created a special period of limitations (seven years) in which refund claims could be filed to claim a deduction on account of losses from worthless debts or securities. Congress created this exceptional period of limitations because taxpayers frequently ascertained the proper year of the deduction only after the normal three year period of limitations had run; it was thought that it would be more equitable to give such taxpayers a longer period within which the deduction could be claimed for the proper year. H. Rep. No. 2333, 77th Cong., 2d Sess., pp. 44-45, 78, 120 (1942-2 Cum. Bull. 372, 408, 432, 461); S. Rep. No. 1631, 77th Cong., 2d Sess., pp. 156-157 (1942-2 Cum. Bull. 504, 620).

The legislative action creating a longer period of limitations within which these specific losses

could be claimed as deductions is another illustration why no similar exception can be created for embezzlement loss short of Congressional amendment of the statute. Further, while Congress extended the statute, there is still a definite limitation of seven years within which loss from worthless debts and securities must be claimed. The taxpayer, Alison, however, would apparently contend that the embezzlement loss can be claimed in the discovery year no matter how many years have elapsed since the embezzlement took place. Moreover, even when discovered within seven years, a loss from a worthless debt or security must still be claimed as of the proper year when the loss was actually sustained, while the taxpayer, Alison, asserts the right to deduct her losses in a year when no loss was sustained.

The disadvantages which this particular taxpayer may experience by being deprived of the loss deduction for some of the earlier years in which the losses were sustained do not stand alone in the balance for, as this Court said in *Rothensies* v. *Electric Battery Co.*, 329 U.S. 296, 301, "a statute of limitation is an almost indispensable element of fairness as well as of practical administration of an income tax policy."[19] The same

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[19] In the *Electric Battery* case, *supra*, p. 302, it was also stated: "As statutes of limitations are applied in the field of taxation, the taxpayer sometimes gets advantages and at other times the Government gets them. Both hardships to the taxpayers and losses to the revenues may be pointed out."

thought was voiced by the Court in *Ross* v. *Commissioner*, 169 F. 2d 483, 494 (C.A. 1st), where it was stated that "The statute of limitations itself has equitable aspects * * *."

Whether the supposed inequity to the present taxpayer is one which should outweigh the equitable aspects of the statute of limitations is not a matter requiring resolution by the courts or by the Commissioner, for we are dealing with a taxing statute where Congress is the sole arbiter of what policy considerations should govern. Equally apt here is the statement in *Rothensies* v. *Electric Battery Co., supra*, p. 303, to the effect that "If there are to be exceptions to the statute of limitations, it is for Congress rather than for the courts to create and limit them."

We believe, accordingly, that the question certified by the Court of Appeals was correctly answered by it in *First Nat. Bank of Sharon, Pa.* v. *Heiner*, 66 F. 2d 925, where it was held that an embezzlement loss was not deductible in the year in which discovered even though (p. 926) "Unfortunately, the period had expired during which an amended return could be filed for the year of the embezzlement * * *." Accord: *Montgomery* v. *United States* (N.D. Ala.), decided September 27, 1932 (15 A.F.T.R. 865). Also, the correct rule was stated by Judge L. Hand when, speaking for the court in *Borden* v. *Commissioner*, 101 F. 2d 44 (C.A. 2d), where it was held that a theft loss was

deductible in the year of the theft and not in the year of discovery, he said (p. 45):

> These considerations would indeed dispose of the case, even if the fraud had not been discovered until it was too late to get a refund for 1931 * * *.

2. The ultimate circumstances on which the taxpayer in *Stevenson-Chislett* bases the right to claim the entire deduction in 1945 of embezzlement losses sustained during prior years, and on which the ruling of the District Court rested (R. 5a-11a), is that, as found by the District Court (R. 5a) "it was a practical impossibility to ascertain the exact year or years in which the succession of shortages occurred."[20]

The hardship which may be experienced by a particular taxpayer who finds it difficult to establish the exact year in which a loss deduction should be taken is, again, not a problem with which the legislature is unfamiliar. The requirement of the statute that losses be deducted in the year when sustained was believed to pose a special problem during the last war with respect to property located abroad in areas coming under

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[20] The District Court also found (R. 5a):

> An attempt to segregate the exact year or years in which such shortages occurred would have required a very detailed and extensive audit and investigation with no assurance that such investigation would have disclosed the actual dates of the acts of embezzlement.

he control of the enemy or in which the war was being fought. Congress was requested to alleviate the difficulties which taxpayers would experience in establishing the precise year of loss with respect to such property. See Hearings on Revenue Revision of 1942 before the House Ways and Means Committee, 77th Cong., 2d Sess., pp. 2528-2538. Congress responded by enacting Code Section 127 which, among other things, established the date on which certain property in war areas or in enemy country would be "deemed" to have been destroyed or seized. The fixing of such a date in the statute obviated the necessity of the taxpayer's establishing the precise date of the loss, and was a practical solution to a difficult problem posed by the existing statutory requirement. S. Rep. No. 1631, 77th Cong., 2d Sess., pp. 40-41, 127-130 (1942-2 Cum. Bull. 504, 538-539, 599-601); H. Conference Rep. No. 2586, 77th Cong., 2d Sess., pp. 48-49 (1942-2 Cum. Bull. 701, 710-711).

Another illustration will be found in the deduction of losses from worthless debts and certain worthless securities. Prior to 1942, the statutory requirement had been that the loss should be deducted in the taxable year in which the debt or security was ascertained to be worthless and was charged off. Because this requirement had been a source of considerable difficulty to taxpayers in determining the year of the deduction or in obtaining the deduction at all, Congress, by Section

124(a) of the Revenue Act of 1942, amended Code Section 23 (k) so as to permit the deduction in the year in which the debt or security became worthless, thus making it easier for taxpayers to claim the deduction in the proper year[21] (H. Rep. No. 2333, 77th Cong., 2d Sess., pp. 44, 76 (1942-2 Cum. Bull. 372, 408, 431); S. Rep. No. 1631, 77th Cong., 2d Sess., pp. 89-90 (1942-2 Cum. Bull. 504, 572).)

The enactment of Code Section 127 and the amendment of Code Section 23 (k) merely illustrate the obvious, namely, that a loss deduction under Section 23 (e) and (f) must be taken in the year in which the loss is sustained and that hardship or difficulty in establishing the year of the loss does not afford any basis for claiming the deduction in a different year, except when Congress sees fit to permit an express deviation. This Court has repeatedly pointed out that deductions are a matter of legislative grace and that a taxpayer must come squarely within the statute to be entitled to a claimed deduction. These are not mere empty phrases. They mean that Congress is completely free to decide what deductions may be used in calculating taxable net income and the terms on which such deductions may be claimed. If a taxpayer finds it difficult or even

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[21] As already noted (p. 43 *supra*), Congress also extended the period of limitations within which these losses could be claimed.

impossible to comply with the conditions on which a particular deduction is granted, that does not obviate the necessity of compliance. For example, in *Burnet* v. *Houston,* 283 U. S. 223, the lower court, in disregard of the plain legislative language, had dispensed with proof concerning March 1, 1913, value as a basis for measuring the extent of a deductible loss on the ground that it was a "sheer impossibility" to do so. This Court disagreed, saying (p. 228):

> We cannot agree that the impossibility of establishing a specific fact, made essential by the statute as a prerequisite to the allowance of a loss, justifies a decision for the taxpayer based upon a consideration only of the remaining factors which the statute contemplates. The definite requirement of § 202 (a) (1) of the act is not thus easily to be put aside. The impossibility of proving a material fact upon which the right to relief depends, simply leaves the claimant upon whom the burden rests with an unenforcible claim, a misfortune to be borne by him, as it must be borne in other cases, as the result of a failure of proof. * * *.

As it relates to losses, the Congressional requirement is that the deduction be taken in the year when the loss was sustained. The fact that it may be difficult or even impossible for the

present taxpayer to claim the loss in the proper year does not constitute a basis on which the Commissioner or the courts can permit the deduction to be claimed in a different, erroneous year. The taxpayer's claim to special treatment here is fairly reminiscent of the taxpayer's contentions in *Boehm* v. *Commissioner*, 326 U. S. 287, to the effect that the loss deductions there should be allowed in the year when they were ascertained rather than the year in which they were actually sustained in order to avoid the difficulties confronting a taxpayer who attempts to choose the proper year for the deduction. This Court, after noting that these difficulties were inherent in Section 23(e), stated that (p. 295):

> Any desired remedy for such a situation, of course, lies with Congress rather than with the courts. It is beyond the judicial power to distort facts or to disregard legislative intent in order to provide equitable relief in a particular situation.

The requirement that a loss be deducted in the year when sustained has existed in the present income statutes since 1913. During this long course of time, although it has acted with respect to other losses, Congress has never indicated that there is any particular need of taking special cognizance of difficulties in proving the year of embezzlement losses. If the legislature should become convinced

that this is a problem area which imposes a special hardship on taxpayers, that is a matter for it, not for the courts or the Commissioner, to cure.

One final observation about the *Stevenson-Chislett* case is in order. The trial judge, it should be noted, did not find that it would be impossible for the taxpayer to establish the years and the amounts of the embezzlement, but rather that it was (R. 5a) "a practical impossibility" to do so. His discussion (R. 6a) amplifies this by stating that a "detailed and extensive audit might have thrown some light" but would "have been burdensome" with "little likelihood of success." He concluded that it was "not reasonable to require the taxpayer to expend substantial sums on an extensive audit" which "had little hope of success in fixing the times of the embezzlements * * * ."

The lower court may have been making the erroneous assumption that the taxpayer would not be entitled to any deduction for the years in which the losses were sustained unless it was able to establish the precise amount embezzled in each year. We believe, on the contrary, that in this situation the court might well have applied the rule of *Cohan* v. *Commissioner*, 39 F. 2d 540 (C.A. 2d), which has been followed by the courts in numerous situations. In that case the Board of Tax Appeals had refused to allow any deduction for travelling and entertainment expenses on the ground that there was no proof of the exact

amount spent. The Court of Appeals reversed, stating (pp. 543-544):

> Absolute certainty in such matters is usually impossible and is not necessary; the Board should make as close an approximation as it can, bearing heavily if it chooses upon the taxpayer whose inexactitude is of his own making. But to allow nothing at all appears to us inconsistent with saying that something was spent. * * * It is not fatal that the result will inevitably be speculative; many important decisions must be such. We think that the Board was in error as to this and must reconsider the evidence.

In the present case, it might well be that the taxpayer, had it made a reasonable attempt, could have carried its investigation at least to the point where a reliable approximation of the amounts embezzled in prior years would have been possible. Even though the precise amounts remained undiscovered, the lower court, following the *Cohan* rule, would have had some basis for determining what deductions were allowable in the proper years. That the taxpayer did not do so is no justification for allowing the entire losses of earlier years to be deducted in the one year which is assuredly the wrong one since no loss was sustained in that taxable period. Of course, if it was impossible for the taxpayer even to make a re-

liable approximation, then it would not be entitled to any deduction, for there is no legitimate basis for allowing a deduction in 1945. Cf. *Burnet* v. *Houston*, 283 U.S. 223.

CONCLUSION

The decision of the District Court in *Alison* v. *United States* (No. 79) should be affirmed. The decision of the District Court in *United States* v. *Stevenson-Chislett, Inc.* (No. 80) should be reversed.

Respectfully submitted,

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OCTOBER, 1952.

APPENDIX A

INTERNAL REVENUE CODE:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(e) *Losses by Individuals.*—In the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

(1) if incurred in trade or business; or

(2) if incurred in any transaction entered into for profit, though not connected with the trade or business; or

(3) of property not connected with the trade or business, if the loss arises from fire, storms, shipwreck, or other casualty, or from theft. No loss shall be allowed as a deduction under this paragraph if at the time of the filing of the return such loss has been claimed as a deduction for estate tax purposes in the estate tax return.

(f) *Losses by Corporations.*—In the case of a corporation, losses sustained during the taxable year and not compensated for by insurance or otherwise.

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(26 U.S.C. 1946 ed., Sec. 23.)

SEC. 43. PERIOD FOR WHICH DEDUCTIONS AND CREDITS TAKEN.

The deductions and credits (other than the corporation dividends paid credit provided in section 27) provided for in this chapter shall be taken for the taxable year in which "paid or accrued" or "paid or incurred", dependent upon the method of accounting upon the basis of which the net income is computed, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period.
* * *

(26 U.S.C. 1946 ed., Sec. 43.)

Treasury Regulations 111, promulgated under the Internal Revenue Code:

SEC. 29.23(e)-1. *Losses By Individuals.*—Losses sustained by individual citizens or residents of the United States and not compensated for by insurance or otherwise are fully deductible if (*a*) incurred in the taxpayer's trade or business, or (*b*) incurred in any transaction entered into for profit, or (*c*) arising from fires, storms, shipwreck, or other casualty, or theft.
* * *

In general losses for which an amount may be deducted from gross income must be evidenced by closed and completed transactions, fixed by identifiable events, bona fide and actually sustained during the taxable period for which al-

lowed. Substance and not mere form will govern in determining deductible losses. Full consideration must be given to any salvage value and to any insurance or other compensation received in determining the amount of losses actually sustained. * * *

* * * * *

Sec. 29.23(f)-1. *Losses by Corporations.*—Losses sustained by domestic corporations during the taxable year and not compensated for by insurance or otherwise are deductible * * *

Sec. 29.43-1. *"Paid or Incurred" and "Paid or Accrued."*—(*a*) The terms "paid or incurred" and "paid or accrued" will be construed according to the method of accounting upon the basis of which the net income is computed by the taxpayer. (See section 48 (c).) The deductions and credits provided for in chapter 1 (other than the dividends paid credit provided in section 27) must be taken for the taxable year in which "paid or accrued" or "paid or incurred," unless in order clearly to reflect the income such deductions or credits should be taken as of a different period. If a taxpayer desires to claim a deduction or a credit as of a period other than the period in which it was "paid or accrued" or "paid or incurred," he shall attach to his return a statement setting forth his request for consideration of the case by the Commissioner together with a complete statement of the facts upon which he relies. How-

ever, in his income tax return he shall take the deduction or credit only for the taxable period in which it was actually "paid or incurred," or "paid or accrued," as the case may be. Upon the audit of the return, the Commissioner will decide whether the case is within the exception provided by the Internal Revenue Code, and the taxpayer will be advised as to the period for which the deduction or credit is properly allowable.

* * * *

Sec. 29.43-2. *When Charges Deductible.*—Each year's return, so far as practicable, both as to gross income and deductions therefrom, should be complete in itself, and taxpayers are expected to make every reasonable effort to ascertain the facts necessary to make a correct return. The expenses, liabilities, or deficit of one year cannot be used to reduce the income of a subsequent year. A taxpayer has the right to deduct all authorized allowances, and it follows that if he does not within any year deduct certain of his expenses, losses, interest, taxes, or other charges, he cannot deduct them from the income of the next or any succeeding year. It is recognized, however, that particularly in a going business of any magnitude there are certain overlapping items both of income and deduction, and so long as these overlapping items do not materially distort the income they may be included in the year in which the taxpayer, pur-

suant to a consistent policy, takes them into his accounts. Judgments or other binding adjudications, such as decisions of referees and boards of review under workmen's compensation laws, on account of damages for patent infringement, personal injuries, or other cause, are deductible from gross income when the claim is so adjudicated or paid, unless taken under other methods of accounting which clearly reflect the correct deduction, less any amount of such damages as may have been compensated for by insurance or otherwise. If subsequent to its occurrence, however, a taxpayer first ascertains the amount of a loss sustained during a prior taxable year which has not been deducted from gross income, he may render an amended return for such preceding taxable year including such amount of loss in the deductions from gross income and may file a claim for refund of the excess tax paid by reason of the failure to deduct such loss in the original return. (See section 322.) A loss from theft or embezzlement occurring in one year and discovered in another is ordinarily deductible for the year in which sustained.

Secs. 19.23(e)-1, 19.23(f)-1, 19.43-1 and 2, Treasury Regulations 103, promulgated under the Internal Revenue Code, are the same as those of Secs. 29.23(e)-1, 29.23(f)-1, and 29.43-1 and 2.

APPENDIX B

October 1, 1952

Mr. Charles S. Lyon
Acting Assistant Attorney General
Tax Division
Department of Justice
Washington 25, D. C.

Dear Mr. Lyon:

In connection with the preparation of the Government's briefs to the Supreme Court in the pending cases of *Alison* and *Stevenson-Chislett*, you have requested a statement as to the practice which has been followed in the Bureau of Internal Revenue on the question of allowing an embezzlement loss to be deducted in the year of discovery where the year of embezzlement is unknown or is barred by limitation.

Pursuant to your request, an inquiry was addressed to Internal Revenue offices in Washington and in selected field offices in the larger cities throughout the country. While the replies to these inquiries do not permit the categorical conclusion that the practice has been wholly consistent, they do manifest a rather clear overtone of permitting embezzlement losses to be deducted only in the year or years of the embezzlement, or not at all.

Replies from a number of these offices do indicate that in some instances, not frequent in occurrence, the loss has been allowed in the year of discovery. However, there appears to be no uniform-

ity of reason advanced ir justification of these allowances in the year of discovery. In a number of larger offices it is indicated that discovery year deductions are sometimes allowed in order to effect settlement. On other occasions the reason advanced is that the loss has in effect been converted into a debt, which is deductible only when it became or was ascertained to have become worthless. One such deduction is said to have been based upon the authority of *Felton* v. *Commissioner*, 5 T.C. 256, 262, acq. 1945 C.B. 3, where the Tax Court said it was unable to find definitely that petitioner's money had in fact been embezzled prior to the date of discovery. One other reason advanced on occasion is the taxpayer's inability to prove the year or years of actual embezzlement, where for settlement purposes deduction has been permitted in the year of discovery. Another office, where the taxpayer shows the total amount embezzled over more than one prior year, not barred by limitation, but is unable to prove how much of the total was embezzled in each of such years, allocates the total embezzled amount among such prior years. However, where the taxpayer is unable to prove the amount of the loss for the actual year or years of embezzlement, the clear majority of replies state that the deduction claimed has been or would be disallowed. Where the statute of limitations has barred the deduction in the year of embezzlement, one office indicates that some allowance may be made in a later year (of discovery) for settlement purposes.

However, in all of the other replies where the inquiry has been specifically put it is indicated that no deduction has been or would be allowed.

Very truly yours,

(Signed) JOHN B. DUNLAP
Commissioner.

pdc

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Nos. 79 and 80

In the Supreme Court of the United States

OCTOBER TERM, 1952

MARTHA L. ALISON

v.

THE UNITED STATES OF AMERICA

THE UNITED STATES OF AMERICA

v.

STEVENSON-CHISLETT, INC.

ON CERTIFICATES FROM THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

REPLY BRIEF FOR THE UNITED STATES

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In the Supreme Court of the United States

OCTOBER TERM, 1952

No. 79

MARTHA H. ALISON

v.

THE UNITED STATES OF AMERICA

No. 80

THE UNITED STATES OF AMERICA

v.

STEVENSON-CHISLETT, INC.

ON CERTIFICATES FROM THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

REPLY BRIEF FOR THE UNITED STATES

There are certain matters in the taxpayer's brief in *United States* v. *Stevenson-Chislett, Inc.* (No. 80), which ought not to remain unchallenged, and the following reply brief is being filed in answer.

1. The taxpayer recognizes that Code Section 23 (e) (3) and (f), in permitting a deduction for embezzlement losses "sustained during the

taxable year," has long been interpreted to mean losses from embezzlements occurring during the taxable year. (Br. 8.) It asserts, however, that if a taxpayer is unable to determine the year or years of the embezzlement, there is (Br. 8) "a well-established exception," evidenced by (Br. 13) "numerous recent Tax Court decisions" within the past ten years which have followed *Boston Consol. Gas Co.* v. *Commissioner,* 128 F. 2d 473 (C. A. 1st), and which should be considered as creating an implied exception to the statute because (Br. 16) "Congress is satisfied with" the results of these cases, so that the statutory word "sustained," in this situation, must mean the year of the (Br. 19) "discovery" of the embezzlement. Upon analysis, it will appear that there is no firm basis for believing that Congress has, by implication, incorporated such an exception into the statute.

The "numerous cases" cited by the taxpayer do not, for the most part, represent the application of any such exception. Thus, *Felton* v. *Commissioner,* 5 T. C. 256 (Br. 11), does not at all stand for the proposition that an embezzlement loss can be deducted in the year of the discovery even though the embezzlement did not take place in that year. In that case, the taxpayer was considered by the Tax Court as having (p. 256) "deposited" money with the wrongdoer for investment. Since the taxpayer in *Felton* had agreed that the recipient of the deposit could commingle

the money with that of others, and could purchase securities representing the aggregate of the interests of several principals, the scheme of the wrongdoer was described by the Tax Court (p. 262) as "resembling that of an investment trust * * * *." Because of the maner in which the funds of the depositors or investors were being manipulated, the Tax Court recognized that the case was not the simple situation where a person's funds were being embezzled. It said (p. 262):

> We think much weight should be given in this case to the fact that petitioner advanced his money under a contract which permitted commingling of funds, and that during 1940 [the taxable year] the contract was still in effect as part of a network of similar contracts.

The Tax Court stated (pp. 262, 263) that "Under the unusual facts," it could not find "definitely that petitioner's [taxpayer's] money was embezzled, stolen, or lost prior to October 1940", and it "found as a fact that the loss was sustained in 1940," the year for which the deduction was being claimed. That factual conclusion could not be described as clearly erroneous. *Gilpin* v. *Commissioner,* decided April 8, 1947 (1947 P-H T. C. Memorandum Decisions, par. 47085), involved another victim of the same scheme considered in the *Felton* case. It is significant that the Tax Court concluded that there was a loss from an "investment", not from an embezzlement.

These cases, accordingly, turning on a resolution of the factual question of the year in which the investment loss occurred, certainly do not stand for the proposition that an embezzlement loss can be deducted in the discovery year when the embezzlement does not take place in that year. Indeed, the fact that neither case cited the decision in *Boston Consol. Gas Co., supra*, is a sufficient indication that the taxpayer is wrong in regarding the *Felton* and *Gilpin* decisions as examples of a supposed exception to the statute. Accordingly, the Commissioner's acquiescence in the *Felton* case (1945 Cum. Bull. 3) does not demonstrate an administrative acceptance of the rule of the *Boston Consol. Gas Co.* case, and the taxpayer is simply wrong in describing the acquiescence as representing instructions by the Commissioner to (Br. 8) "his subordinates in the Bureau" to accept the peculiar construction of the statute for which the taxpayer is contending.

It is questionable whether *Glenn* v. *Louisville Trust Co.*, 124 F. 2d 418 (C. A. 6th) (Br. 10), was correctly decided. However, that case, like the *Felton* and *Gilpin* decisions, did not involve any problem of embezzlement and it did not touch on the meaning of the statute here in question. The taxpayer recognizes (Br. 10–11) that *Miglietta* v. *Commissioner*, decided January 28, 1943 (1943 P–H T. C. Memorandum Decisions, par. 43045), is a decision where the embezzlement loss

was deductible, not in the year of discovery, but in the year when the embezzlement took place.

The "numerous recent Tax Court decisions" relied on by the taxpayer, consequently, are represented by only one case, i. e., *Gwinn Bros. & Co. v. Commissioner*, 7 T. C. 320 (which followed *Boston Consol. Gas Co. v. Commissioner*, 128 F. 2d 473 (C. A. 1st)). It is important to observe that in the *Gwinn* case the taxpayer had relied on the embezzler's express promise to repay—a promise which was later discovered to be worthless and which the taxpayer claimed entitled it to a bad debt deduction. Although the Tax Court did not rest its conclusion on the bad debt aspect of the case, the fact that the Commissioner acquiesced only in the result of the decision (1946-2 Cum. Bull. 2) demonstrates that there has been no administrative acceptance of the *Boston Consol. Gas Co.* rule.

In our opening brief it was pointed out that (p. 37): "We have been unable to discover any published ruling, interpretation, or instruction in which the Commissioner has construed the Regulations to possess such a meaning." The taxpayer, it can now be added, points to nothing which would demonstrate an administrative construction which recognizes the exception which it seeks to create. On the contrary, as is evident not only from this case and the *Alison* case (No. 79), but from all the reported decisions, the Government has consistently adhered to the posi-

tion that the loss cannot be deducted in a year in which there was no embezzlement. The opposite result of the *Boston Consol. Gas Co.* case and the opposite rationale of the *Gwinn Bros.* case do not, in the slightest degree, indicate a Congressional acceptance of those cases. As this Court said in *Jones* v. *Liberty Glass Co.*, 332 U. S. 524, 534: "We do not expect Congress to make an affirmative move every time a lower court indulges in an erroneous interpretation." Accord: *Commissioner* v. *Wheeler*, 324 U. S. 542, 545–546.[1]

The ultimate fact remains, as was pointed out in our opening brief (pp. 13–17), that the word "sustained" has, from the very beginning, been consistently construed to mean the year of the embezzlement and no other year. Since there has been no accepted practice which recognizes any defined exception to this long, continued construction, there is no room to argue that Congress has by its silence impliedly accepted any supposed exception.

2. The taxpayer (Br. 19–25) next argues that, in any event, the statutory word "sustained" is,

---

[1] Even within the limits of its argument, taxpayer would find it hard to explain why Congress, by its silence, would have accepted as a proper construction not only the result in *Boston Consol. Gas* but also that of *First Nat. Bank of Sharon, Pa.* v. *Heiner*, 66 F. 2d 925 (C. A. 3d), for those decisions, while dealing with different aspects of the problem, are utterly out of harmony with one another.

by itself, flexible enough to permit a construction so that an embezzlement loss, in the circumstances of this case, is "sustained" when it is discovered, even though in other instances where the year of embezzlement and the year of discovery do not coincide it is "sustained" when the embezzlement takes place.

The taxpayer is unable to cite any persuasive authority which would demonstrate that Congress ever intended such a shifting meaning or that this loose definition is supported by any accepted administrative practice. The fact that the 1921 Act (the history of which is fully discussed in our opening brief, pp. 22–28) expressly added language to provide for the exceptional allowance of loss deductions in other years to clearly reflect income (though not necessarily covering the situation here) demonstrates that the existing word "sustained" was not so elastic in its meaning, for otherwise no exception would have been needed. When that exception was removed from the loss provisions by the 1924 Act, it seems plain that the word "sustained" in connection with embezzlement losses continued to mean what it had before, namely, the year in which the embezzlement occurs.

The taxpayer cites (Br. 22–23) *Lucas* v. *American Code Co.*, 280 U. S. 445; *Burnet* v. *Huff*, 288 U. S. 156; and *Boehm* v. *Commissioner*, 326 U. S. 287, as requiring a "practical" test for determin-

ing when a loss is sustained. Aside from the fact that those cases dealt with the question of when other kinds of losses should be regarded as sustained—a matter which, by administrative and judicial interpretation, has already become well settled for embezzlements—it should also be pointed out that the accepted interpretation which considers the loss as sustained when the embezzlement takes place is a practical one. It places the loss at an identifiable time so that neither the taxpayer nor the Government may attempt to shift the year of the deduction to suit their own tax advantage. That practical result would be lost if there were some vague exceptions which might permit the deduction to be claimed in more than one possible year.

The taxpayer's real complaint is not that the rule is impractical, but rather that a practical rule may sometimes result in hardship. The *Boehm* case (p. 295), however, demonstrates that the alleviation of any supposed inequity or hardship is to be accomplished by Congressional action and not by a judicial departure from a well-settled statutory meaning.[2]

[2] Throughout its brief, the taxpayer constantly assumes that it would be impossible for it to determine the precise years of the embezzlement, and that the application of the statutory rule would deprive it of the deduction altogether. In our opening brief (pp. 51–52) we point out why that is not necessarily so in the light of the actual findings of this case.

3. The taxpayer's next contention (Br. 25–30) seems to be that *Commissioner* v. *Wilcox*, 323 U. S. 404, overturned the previous, long accepted rule that an embezzlement loss is "sustained" when the embezzlement occurs. Because the *Wilcox* decision spoke of a debtor-creditor relationship arising out of the act of embezzlement, the taxpayer argues that (Br. 28)—

> the victim of an embezzlement should not be regarded as sustaining a loss at the time his funds are surreptitiously taken, but only when the fact of the loss becomes fixed and definite and the amount becomes reasonably determinable

and it concludes that an embezzlement loss is deductible (Br. 29–30) "in the year when it is determined how much of the embezzled funds are recoverable."

If it were valid, that reasoning, of course, would be applicable to *every* embezzlement situation, and could not be used to explain why the result in this case should be different from that in any other case. If the loss is considered as sustained only after the victim is aware of what has been lost, that would be universally true, even in the ordinary case where the loss is discovered the year after the embezzlement occurs. In such a case, if taxpayer is right, the loss could not be taken in the year of embezzlement because in that year it was not—and could not—be determined whether

the embezzler's obligation to repay the embezzled funds was in fact worthless. But, if there is anything in this field which is clear beyond question, it is that in such a case the loss is taken in the year of embezzlement. The *Wilcox* case, with the totally different problem there involved, was not intended to disturb the long, continued administrative and judicial construction which, from the very outset, has been put on Section 23 (e) (3) and (f) and its predecessors, namely, that the year in which an embezzlement loss is "sustained" does not depend on when it is ascertained that the claim against the embezzler is a worthless bad debt. Indeed, in *Rutkin* v. *United States*, 343 U. S. 130, 138, the *Wilcox* decision was said to be limited "to its facts."

This is not to suggest, if this were a matter of first impression, that the word "sustained" could not, as a matter of language, have been construed to have such a meaning, or that it would have been wrong for the Commissioner to have so interpreted the statute. We do, however, deem it clear that when the opposite construction has been followed for almost more than 35 years, the statute cannot suddenly have changed its meaning because of a decision which not only dealt with a different question (gain to the embezzler) but which expressly noted (p. 409) that there was no necessary relationship between the issue there and the deductions granted by Congress to the victim. If the settled meaning of the

statute is now to be changed, that should be done by Congress.[3]

4. Finally, the taxpayer urges (Br. 30-36) that, regardless of when the embezzlement loss was "sustained" within the meaning of Section 23, it should be permitted to deduct the losses of prior years in the taxable year because Code Section 43 requires such a result in order clearly to reflect the taxpayer's income.

We need not reply to the specific matters relied on by the taxpayer, for they are covered in our opening brief (pp. 18–39) where we have demonstrated why Section 43 is not applicable to embezzlement losses.

We do note, however, that nowhere in its discussion does the taxpayer explain how its income for 1945 (a year in which there admittedly was no embezzlement of its funds, and in which nothing else occurred which would have a bearing on its taxable gains of that period) is being reflected more clearly by means of a deduction on account of losses sustained in prior year. Nor

---

[3] The taxpayer also argues (Br. 29–30) that its construction of the statute is supported by the language of Section 23 which limits the loss deduction to the extent "not compensated for by insurance or otherwise," it being contended that this demonstrates why the embezzlement loss is not sustained until the year when the victim ascertains the loss and the extent to which reimbursement is obtainable.

The short answer to that is that the same language has always been in the statute during the long course of time that the opposite construction has been accepted.

does the taxpayer attempt to clarify how the deduction of several years' losses in a single taxable year can be harmonized with Section 43 whose very purpose is to the contrary. The result which the taxpayer seeks will distort its 1945 income, rather than reflect it more clearly. This would contradict and frustrate the express purpose of Section 43.

5. The ultimate effect of the taxpayer's position is that one or more of the statutory provisions should be stretched in some manner or other to grant it relief from a harsh result in this particular situation. The taxpayer (Br. 15–16) does not contend that the statute should be so construed as to embrace every situation where a hardship is being claimed, for it contends that the exception can be read into the statute which will take care of its case, though not necessarily the situation where, as in the *Alison* case (No. 79), the discovery comes too late to permit the deduction to be claimed for the embezzlement year.

We submit, however, that if different exceptions are to be created for different situations, that is a matter properly addressed to the attention of the legislature. As we have pointed out in our opening brief (pp. 39–51) Congress is familiar with problems of this sort and it knows how to deal with them when it so intends. We also there noted why a legislative change, if there ever should be one, would not necessarily coincide

with the solution which these taxpayers seek by judicial decision.

Aside from the fact that a taxpayer who is dissatisfied with the operation of a statute should more properly submit the claimed grievance to the legislative branch of the Government, it seems appropriate to observe that there is no identifiable standard by which the judiciary can fashion an exception tailored for the present cases. Thus, with respect to the type of problem presented by this case, if an exception is created, the question must arise whether the deduction can be had in the discovery year only if it is *impossible* to ascertain the exact years of the embezzlement, or whether the exception will apply as well when it is (as seems to be true here) merely too expensive to ascertain that fact. If it is to be the latter, is the expense limit to be determined in relation to the size of the loss deduction? What should the result be if the fact of the embezzlement is discovered in one year and the impracticability of ascertaining the embezzlement years is not learned until later? Finally, both this case and the *Allison* case present the problem of how, if the discovery year is to be the deduction year, there can be avoided the necessary distortion of income that must ensue if the losses of more than one year are to be lumped as a single deduction in a single tax year—a distortion of income against which the statute expressly guards in Section 43.

These are some of the problems that are bound to attend the creation of the kind of exception which these taxpayers are urging. If Congress should ever carve out such an exception, it would undoubtedly do it in a manner designed to answer these attendant issues in accordance with some legislative principle—a solution which, in the absence of such a standard, cannot be supplied by judicial decision.

CONCLUSION.

The decision of the District Court in *Alison* v. *United States* (No. 79) should be affirmed. The decision of the District Court in *United States* v. *Stevenson-Chislett, Inc.* (No. 80) should be reversed.

Respectfully submitted.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1952

NO. 80

THE UNITED STATES OF AMERICA,
Petitioner,

v.

STEVENSON-CHISLETT, INC.,
Respondent.

On Certificate from the United States Court of Appeals for the Third Circuit.

BRIEF FOR THE RESPONDENT

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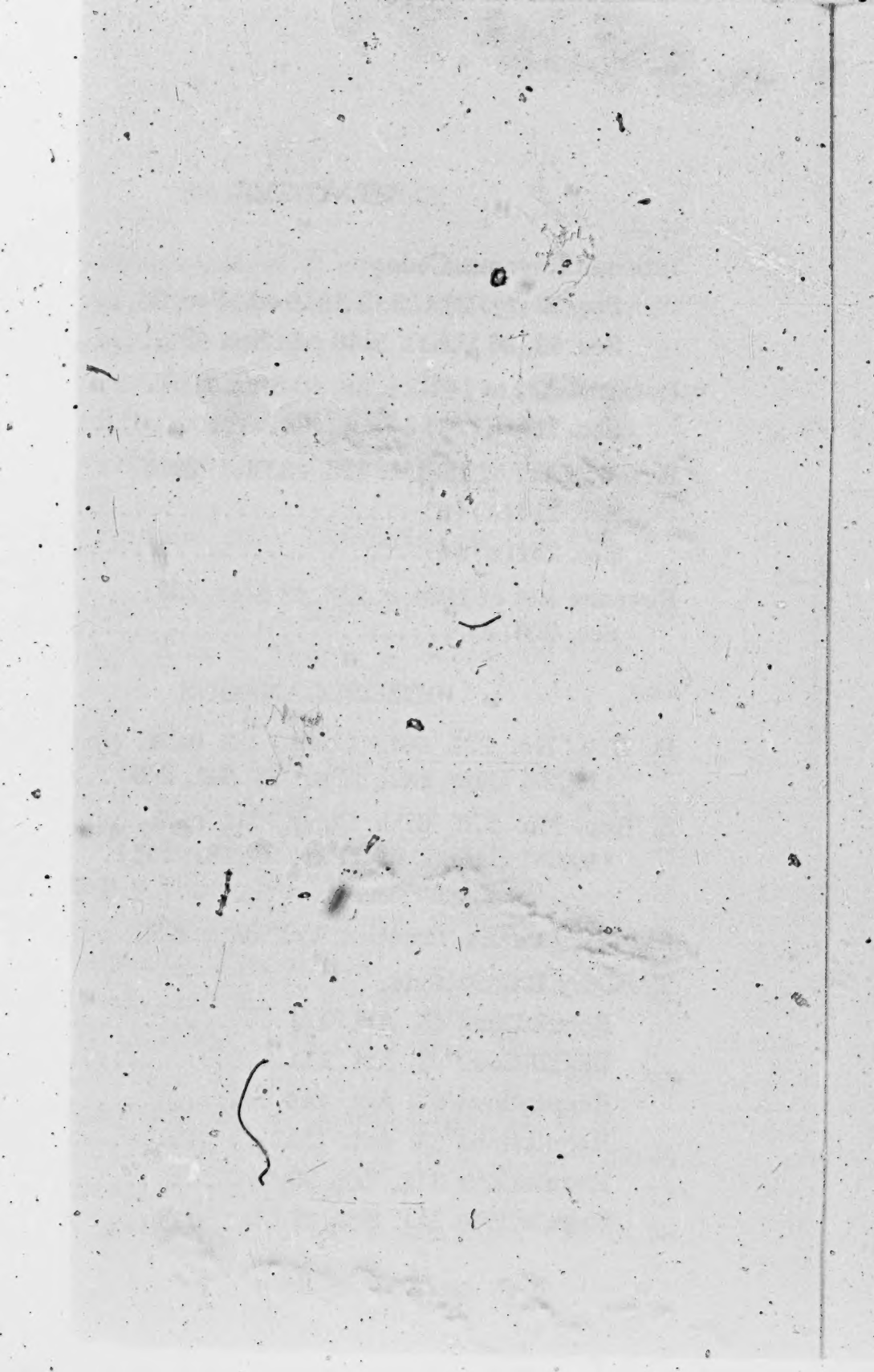

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STEVENSON-CHISLETT, INC.,
Respondent.

On Certificate from the United States Court of Appeals for the Third Circuit.

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The opinion of the District Court (R. 3a-11a) is reported at 98 F. Supp. 252. The Court of Appeals did not issue an opinion.

JURISDICTION

The judgment of the United States District Court for the Western District of Pennsylvania in favor of the plaintiff, Stevenson-Chislett, Inc., against the defendant, The United States of America, was entered on June 28, 1951. The defendant appealed the case to the Court of Appeals for the Third Circuit, which, on May 23, 1952, certified to this Court the question of law hereinafter stated (R. 13-16). On June 9, 1952, this Court ordered the entire record in this case sent up so that this Court might decide the entire matter in controversy (R. 16). The jurisdiction of this Court rests on section 1254(3) of Title 28 of the United States Code.

QUESTION PRESENTED

When a taxpayer has suffered embezzlements over a period of years prior to 1945 but the actual years in which the several acts of embezzlement took place are unknown and it is a practical impossibility to ascertain them, are the losses resulting from such embezzlements deductible by the taxpayer under Section 23 of the Internal Revenue Code in computing its taxable net income for the year 1945, in which year the embezzlements were discovered and the net loss therefrom was ascertained?

STATUTE AND REGULATIONS INVOLVED

Section 23(f) of the Internal Revenue Code, 26 U. S. C. Sec. 23, provides:

"Sec. 23. DEDUCTIONS FROM GROSS INCOME.
In computing net income there shall be allowed as deductions:

* * * * * * *

(f) LOSSES BY CORPORATIONS. — In the case of a corporation, losses sustained during the taxable year and not compensated for by insurance or otherwise."

Section 43 of the Internal Revenue Code, 26 U.S.C. Sec. 43, provides:

"Sec. 43. PERIOD FOR WHICH DEDUCTIONS AND CREDITS TAKEN.

The deductions and credits . . . provided for in this chapter shall be taken for the taxable year in which 'paid or accrued' or 'paid or incurred', dependent upon the method of accounting upon the basis of which the net income is computed, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period . . ."

Treasury Regulations 111, promulgated under the Internal Revenue Code, state:

"Sec. 29.43-2. When Charges Deductible. —

* * *

A loss from theft or embezzlement occurring in one year and discovered in another is ordinarily deductible for the year in which sustained."

COUNTER-STATEMENT OF THE CASE

The Statement of the Case presented in the Government's brief (pp. 5-7) is accurate, except that the following additional matter in the record should be mentioned:

Initially, the respondent claimed the loss resulting from the embezzlement as a deduction for the year 1944. Upon audit of the respondent's 1944 tax return, officers of the Bureau of Internal Revenue took the position that the loss was not deductible in 1944 because it was not discovered or ascertained until 1945, and disallowed the deduction claimed for 1944. The respondent yielded to this position, filed a claim for refund of income tax for 1945 and subsequently instituted this action. The respondent does not, of course, claim the deduction for both years (Tr. 50).

SUMMARY OF ARGUMENT

A. The general rule of the older lower court cases is that an embezzlement loss is deductible for the year in which the act of embezzlement took place, even though the embezzlement may not be discovered until a later year. There is, however, a well recognized exception to this general rule: if the taxpayer is unable to discover when the embezzlement occurred, the loss is deductible for the year in which the embezzlement is discovered and the amount ascertained. *Boston Consolidated Gas Co. v. Commissioner,* 128 F. 2d 473 (1st Cir., 1942). The cases relied on by the Goverment, such as *Borden v. Commissioner,* 101 F. 2d 44 (2nd Cir., 1939) and *First National Bank of Sharon v. Heiner,* 66 F. 2d 925 (3rd Cir., 1933) are distinguishable because the year in which the actual embezzlement occurred was

known. Those cases do not hold that an embezzlement loss must be deducted for the year of occurrence if the year of occurrence cannot be ascertained.

The applicable Treasury Regulations providing that a loss from theft or embezzlement occurring in one year and discovered in another is *ordinarily* deductible for the year in which sustained, clearly recognize that in *extraordinary* cases embezzelement losses may be deducted for a year other than that in which the act of embezzlement occurred. *Boston Consolidated Gas Co. v. Commissioner, supra; Gwinn Brothers & Co.*, 7 T. C. 320 (1946). The Treasury Regulations have remained unchanged since those decisions.

B. The *Boston Consolidated Gas* line of cases is not in disregard of the statutory language contained in Section 23(f), but is a proper interpretation of the statute. Congress intended the statute to be flexible in order, in the interests of justice to the taxpayer, to permit elastic treatment of such losses (S. Rep. 275, 67th Cong., 1st sess., pp. 14-15, 1939-1 Cum. Bull. [Part 2] 181, 191), and this Court has construed it as calling for a practical and not a legal test. *Burnet v. Huff*, 288 U. S. 156 (1933). From a practical standpoint, a taxpayer should not be required to deduct a loss as of a particular time when he has no way of knowing when that time was. This construction of the statute is in accord with the basic principle reiterated by this Court in *Dixie Pine Products Co. v. Commissioner*, 320 U. S. 516 (1944), that liabilities that remain uncertain or unknown during the taxable year do not constitute allowable deductions for such year, but are deductible only when the liability has become fixed and definite and reasonably ascertainable in amount.

C. Older cases in the lower courts established a general rule, relied on by the Government, that embezzlement losses are deductible only in the year of occurrence on the ground that there is no debtor-creditor relationship. But *Commissioner v. Wilcox*, 327 U. S. 404 (1945), held that an embezzler realizes no taxable income at the time of his embezzlement because there is a definite and unconditional debtor-creditor relationship so that the embezzler has a concurrent obligation to repay. Logically, therefore, his victim does not "sustain" a loss at the time of embezzlement, but only when the embezzlement has been discovered and it is determined what amount of the embezzled funds is not recoverable. *Boston Consolidated Gas Co. v. Commissioner*, 128 F. 2d 473, 477 (1st Cir., 1942); *Gwinn Brothers & Co.*, 7 T. C. 320, 325 (1946).

Section 23(f) permits the deduction of losses sustained during the taxable year unless "compensated for by insurance or otherwise". Even if, despite the reasoning of this Court in its *Wilcox* opinion, the embezzlement loss is regarded as "sustained" in the year the act of embezzlement occurs, the unqualified duty and obligation of the embezzler to repay the money would at the very least bring the loss within the scope of the statutory phrase "compensated for by insurance or otherwise" and the loss would be a permissible deduction in the year it is determined the extent to which the embezzled funds are recoverable.

D. In any event, under Section 43 of the Internal Revenue Code, a loss, such as an embezzlement or casualty loss, should be allowed as a deduction in the year it becomes known regardless of when it was

"sustained", if such allowance is necessary to clearly reflect income. The legislative history of antecedent provisions contained in earlier Revenue Acts demonstrates Congressional intent that such losses occurring in one year and discovered in another fall within the scope of Section 43. Sections 214(a)(6) and 234(a)(4) of the Revenue Act of 1921 permitted losses, including embezzlement losses, to be deducted for a year other than that in which sustained where necessary to clearly reflect income. This provision was applicable to a loss from an embezzlement occurring in one year, but not becoming known until a later year. Reg. 62, Art. 146; S. Rep. No. 275, 67th Cong., 1st sess., pp. 14-15, 1939-1 Cum. Bull. [Part 2] 181, 191. Although this provision did not appear in the same section in the Revenue Act of 1924, it was not omitted from the statute. On the contrary, it was broadened to cover not only losses, but all deductions and credits, and was incorporated in Section 200(d) of the 1924 Act. H. Rep. No. 179, 68th Cong., 1st sess., pp. 10-11, 1939-1 Cum. Bull. [Part 2] 241, 249. That section was the predecessor of, and its language, in so far as here material, was substantially similar to the present Section 43 of the Internal Revenue Code, which was in force during 1945. Thus, the provision of the 1921 Act permitting losses to be deducted for other than the year in which sustained, though extended by the 1924 Act to all deductions and credits, is still in effect. Under that provision in its broadened form, the taxpayer, since it does not know when its money was embezzled, should be permitted to deduct its loss for 1945, the year of discovery. Otherwise it will never get any deduction for its loss contrary to the plain intent of Congress.

ARGUMENT

I. When the Time of Actual Embezzlement Is Unknown the Deduction of an Embezzlement Loss in the Year of Discovery Is Supported by the Decided Cases and by the Applicable Treasury Regulations.

Where a taxpayer has suffered a loss from embezzlement, the so-called general rule of the lower courts is that the loss is deductible in the year in which the act of embezzlement took place. As the Government contends (p. 15), this is ordinarily true under the existing decisions even though the embezzlement is not discovered until a later year. There is, however, a well-established exception to the general rule in those cases in which the taxpayer is unable to determine when the embezzlement took place. Under such circumstances the lower courts have held the loss allowable as a deduction for the year in which it is discovered by the taxpayer and its amount ascertained. Several of these decisions have been acquiesced in by the Commissioner of Internal Revenue and, therefore, despite the Commissioner's implication to the contrary in his letter of October 1, 1952, appearing in Appendix B of the Government's brief (pp. 59-61), his subordinates in the Bureau are under instruction to follow them in the administrative disposition of similar cases. While the Commissioner's letter may show an unfortunate lack of uniformity in the administrative handling of taxpayers' cases in the various field offices of his Bureau, it does not alter the fact that his continuing acquiescence in a decision of the Tax Court constitutes instructions to his subordinates to follow it.

Argument.

In *Boston Consolidated Gas Co. v. Commissioner*, 128 F. 2d 473 (1st Cir., 1942), the taxpayer discovered in 1935 that its treasurer had embezzled a substantial sum, and it was able to recover only part of the funds. The taxpayer was unable to determine in what year prior to 1935 the great bulk of the embezzlement had occurred and it claimed the loss as a deduction in 1935. The Commissioner contended, however, that only the small amount actually embezzled in 1935 was deductible in that year. The court, in deciding the case for the taxpayer, recognized that in the ordinary case an embezzlement loss is deductible for the year in which the embezzlement occurs even though it is not discovered until a later year. The court stated, however, that although this general rule is appropriate in the ordinary case, Congress intended it to be flexible and subject to modification to avoid unjust results. It pointed out that the applicable Treasury Regulations support this conclusion in that they provide only that embezzlement losses are *ordinarily* deductible for the year in which the taking actually occurs. In an unusual case, as where the taxpayer cannot determine the exact year or years involved, the Regulations do not prohibit deduction for the year in which the loss is discovered and the amount ascertained. The court emphasized the injustice that would result from a rigid and inflexible application of the general rule to all cases, pointing out that in most cases justice could be achieved by filing amended returns for the years in which the embezzlements took place, but that here the taxpayer did not know the years involved. The court therefore held that the taxpayer was entitled to deduct the full amount claimed in 1935, the year in which the loss was discovered and its amount

ascertained. The Government did not file a petition for certiorari.

In *Glenn v. Louisville Trust Co.*, 124 F.2d 418 (6th Cir., 1942), the court arrived at a similar result with respect to a type of loss analogous to an embezzlement loss. It held that a loss arising out of a fiduciary's unauthorized investment which became worthless was not deductible until the loss had been discovered and its extent ascertained. In urging that the *Boston Consolidated Gas* case is unsupported by any precedent (p. 20), the Government mentions the *Louisville Trust Co.* case and dismisses it from consideration on the ground it did not deal with the time for deduction of an embezzlement loss. But similar tax problems should be governed by similar principles, and we respectfully submit that the *Louisville Trust Co.* case is a precedent, the basic reasoning of which supports the decision reached in the *Boston Consolidated Gas* case.

This exception to the general rule of the older cases —that embezzlement losses are deductible for the year in which the act of embezzlement occurs—has also been recognized and followed by the Tax Court consistently for the past ten years:

Shortly after the decision in the *Boston Consolidated Gas* case, the Tax Court followed the general rule on the facts involved in *Maria G. Miglietta*, 1 T.C.M. 499 (1943), since the exact year of the occurrence of the embezzlement was known. However, the Tax Court expressly recognized that when there are extraordinary facts, such as where the taxpayer cannot ascertain the year of embezzlement, the rule of the *Boston Consolidated Gas* case applies and the taxpayer is entitled to

deduct the loss in the year of discovery. It is wrong, therefore, for the Government to cite this case in its favor (p. 15).

In *Samuel M. Felton,* 5 T.C. 256 (1945), the taxpayer in 1938 gave an agent $20,000 to invest for him. Since 1933 the agent had been in the business of managing funds for others under contracts which permitted the intermingling of funds. In 1940 the agent absconded, and thereafter in the same year the taxpayer learned that all the agent's monthly statements had been false and that he had actually been insolvent since 1933. The taxpayer claimed that the loss was deductible in 1940 when he first discovered the embezzlement, but the Commissioner contended that the loss was incurred sometime prior to 1940. The Tax Court allowed the loss in 1940, pointing out that until the agent absconded his scheme of manipulation was working, that because of the intermingling of funds it was impossible for the taxpayer to ascertain the exact year in which his own funds had been misappropriated, and that under these facts he should not be compelled to do so. This decision was followed on the same facts in *Lucy D. Gilpin,* 6 T.C.M. 370 (1947), where the taxpayer wanted a different year and the Commissioner successfully argued that the *Felton* case was right and should be followed.

In *Gwinn Brothers & Co.,* 7 T.C. 320 (1946), the taxpayer discovered in 1935 that one of its employees had been embezzling its funds for an indefinite period of years, and that the employee was insolvent and the funds could not be recovered. The amounts embezzled during the years 1932 through 1935 were ascertained, and deductions therefor were allowed by the Commissioner

for those years. The amounts embezzled prior to 1932, however, were not allocable to particular years, and the taxpayer deducted this balance of the embezzlement loss in 1935, the year of discovery. As to this amount in controversy, the Tax Court held that since the taxpayer had no way of ascertaining the year or years of embezzlement, the loss was sustained and deductible in 1935. The Tax Court discussed with approval the *Boston Consolidated Gas* case, and added (p. 325):

> ". . . the petitioner, under the above facts, could not in any particular year prove loss of any particular amount. We think, therefore, that this case falls outside the 'ordinary rule' as announced in various cases (prior to the *Wilcox* case, *supra*), and that the cases relied upon by the respondent should not here control."

It is noteworthy that the Commissioner of Internal Revenue has published his acquiescence in the *Felton* and *Gwinn* cases. 1945 Cum. Bull. 3; 1946-2 Cum. Bull. 2. It is true, as the Government says (p. 18), that as to *Gwinn* the acquiescence was as to result only; but the acquiescence as to *Felton* was unlimited. In addition, no petition for certiorari was filled by the Government in the *Boston Consolidated Gas* case. These decisions have been in force and unchallenged for some time, and notwithstanding the letter written by the Commissioner last month for use in the Government brief (p. 59), were doubtless the reason why the taxpayer in this case was told by Bureau officers that the deduction should be claimed in 1945 rather than 1944 (Tr. 50).

The Government cites fifteen older decisions in support of its position that an embezzlement loss may be

deducted only for the year in which the actual taking occurs (p. 15). But in only one of these fifteen was the actual year of embezzlement unknown: *J. A. Bentley*, 5 B.T.A. 314 (1926). In all the other cases the taxpayer knew the exact year in which the act of embezzlement had occurred. Those decisions, therefore, merely apply the "ordinary" rule of the Regulations to the ordinary case, and are fully reconcilable with the *Boston Consolidated Gas* line of cases. And the *Bentley* case itself has been effectively overruled by the numerous recent Tax Court decisions, following *Boston Consolidated Gas*, dealing with an unknown year of embezzlement.

The Government asserts (pp. 15-16) that there are two cases involving "losses from thefts deductible in years of theft and not in later years when first discovered." However, *Howard J. Simons*, 1 B.T.A. 350, did not involve a refusal to allow a 1921 loss by theft "not discovered until 1922" (p. 25). Instead, there were two alleged thefts, one in 1921 and one in 1922. As to the 1921 theft, it was discovered in 1921, and held not deductible in 1922; as to the 1922 alleged theft, it was held the evidence did not prove there was a theft. *Borden v. Commissioner*, 101 F.2d 44 (2d Cir., 1939), being another application of the ordinary rule to the ordinary case, is also not in point. One Coutant, representing himself to be an attorney, obtained a sum of money from the taxpayer in 1931 under false pretenses. Before the end of 1931 the taxpayer became suspicious and retained another attorney to investigate the matter. Early in 1932 is was discovered that Coutant was an ex-convict and not an attorney at all, and that the taxpayer had been defrauded. On these facts the court held that the

loss was deductible in 1931 rather than 1932, saying (p. 45):

> "Coutant never meant to restore the money; it was a retainer, paid to him as his own, intended for him to keep. He was not a disloyal trustee who expected to make good a defalcation, but an ordinary rogue who meant to disappear with his loot before he was detected; at least Borden, who had the burden, has not shown the contrary. These considerations would indeed dispose of the case, even if the fraud had not been discovered until it was too late to get a refund for 1931; but that argument, whatever it may be worth, is met by the fact that Borden learned everything probably by March 15, 1932, when his return for 1931 was due, but in any case in ample season to get a refund, if he had already paid his tax for that year."

On the facts of that case, it is apparent that not only was the year in which the taking occurred known to the taxpayer, but also the loss was discovered in ample time to permit the deduction to be claimed for such year. Thus, the *Borden* case is just another application of the general rule to the "ordinary" case.

The Government quotes (pp. 14-15) from the decision of this Court in *Burnett v. Huff*, 288 U. S. 156 (1933). The concession made by the Government in that case and referred to by the Court (p. 159) merely restates the general rule applicable to the ordinary case where the year of embezzlement is known; it does not purport to deal with the extraordinary factual situation involved in the *Boston Consolidated Gas* case and here. In the *Huff* case, one of two partners embezzled

money in 1920 from a trust fund held by the firm, and paid it to the other partner in discharge of a debt which the firm owed to him. The innocent partner discovered the embezzlement in 1920, and in 1921 he restored the full amount to the fund, paying part with the firm's assets and part from his own funds. This Court, in holding that the amount repaid in 1921 could not be deducted as a loss in 1920, said (p. 161):

> "The requirement that losses be deducted in the year in which they are sustained calls for a practical test."

Certainly there is nothing "practical" about the Government's position which would require a taxpayer to determine the exact year in which an embezzlement occurred when, on the facts, that is impossible. On the other hand, the *Boston Consolidated Gas* line of cases does furnish a practical and a fair test for determining the year of deductibility of an embezzlement loss in those situations where the exact year of the taking is unascertainable.

The Government also relies on *First National Bank of Sharon v. Heiner*, 66 F.2d 925 (3rd Cir., 1933), but as pointed out in the opinion of the District Court, that case is clearly distinguishable on its facts from the *Boston Consolidated Gas* case and the present proceeding (R. 9a-10a). In the *Sharon Bank* case, the exact dates on which the acts of embezzlement took place were known, and this fact also distinguishes *Alison v. United States* (pending before this Court at No. 79), as noted by the Government in its brief (pp. 10, 12). Whether those decisions are correct on their particular facts or whether, on the other hand, the *Alison* case should be reversed

as being erroneous in principle, is a question to which we need not address ourselves under this head of argument dealing with the precedents in point. It is enough for us to point out that those cases are distinguishable on a material fact and, hence, are not contrary to the decisions on which we rely.

Analysis of the foregoing decisions shows that when the Government argues (p. 17) that "repeated reenactment of the statute demonstrates that Congress intended that the word 'sustained' be so interpreted", it is arguing for the taxpayer. This is so because, as we have seen, almost without exception the older cases relied on by the Government did not involve an unknown year of embezzlement. The *Boston Consolidated Gas* case and the numerous Tax Court cases following it have allowed the deduction in the year of discovery where the year of embezzlement was unknown, and Congress has not disapproved. And the same criticism may fairly be made of the Government argument that Congress has remedied other inequities but has not remedied this one (pp. 40-51). From this statement the Government concludes that Congress is satisfied with the inequity. But the fact is that where the year of embezzlement is unknown, the decisions have favored the taxpayer. The right conclusion, we submit, is that Congress is satisfied with the equitable result of the *Boston Consolidated Gas* line of cases.

We believe that the distinction we make of the Government's cases is sensible. If it is known exactly when and how much has been embezzled, a loss can be claimed for that year, at least within the period permitted by the applicable statute of limitations. But if

the years are not known and cannot be ascertained, then the loss can be claimed, if it is to be claimed at all, only when discovered.

The distinction, we submit, is recognized by Treasury Regulations. Section 29.43-2 of Regulations 111 provides:

> "* * * A loss from theft or embezzlement occurring in one year and discovered in another is *ordinarily* deductible for the year in which sustained." (Italics ours)

The plain meaning of the words used according to common usage and in context necessarily implies that in some extraordinary factual situations the loss may be deducted for a year other than the one in which the actual taking occurs. Reading this Regulation in the light of the prior Regulation on the subject serves to emphasize this necessary implication. Regulations 45, Article 111, promulgated under the Revenue Act of 1918, provided that "A loss from theft or embezzlement occurring in one year and discovered in another is deductible *only* for the year of its *occurrence.*" (Italics ours). However, Regulations 62, Article 111, promulgated under the Revenue Act of 1921, changed this language to provide that an embezzlement loss "occurring in one year and discovered in another is *ordinarily* deductible for the year in which sustained" (Italics ours), and that provision has remained unchanged in all subsequent Regulations up to the present time. Reading these two Regulations together, it is apparent that under the newer Regulation embezzlement losses may, in *extraordinary* cases, be deducted for a year other than that in which the act of taking occurred, and the

Regulation has been so construed by the courts. *Boston Consolidated Gas Co. v. Commissioner*, 128 F.2d 473, 476; *Gwinn Brothers & Co.*, 7 T. C. 320, 324.

This Regulation has existed in its present form for nearly thirty years, and during that period the statutory provisions governing the time for deduction of embezzlement losses have been reenacted without substantial change on numerous occasions. It is well established that Treasury Regulations long continued without change, applying to reenacted statutes, are deemed to have received Congressional approval and have the effect of law. *Boehm v. Commissioner*, 326 U.S. 287, 291-292 (1945); *Lykes v. United States*, 343 U.S. 118, 127 (1952). The Government seeks to avoid the damaging effect of the word "ordinarily" by arguing that its retention in Treasury Regulations after 1924 was "apparently an oversight" and the word is only a "vestigial appendix" (pp. 34-35). The simple answer is this "oversight" was forcefully called to the attention of the Commissioner in 1942 by the *Boston Consolidated Gas* case, and in the ten years since that time the Regulations in this respect have not been changed. Accordingly, in a case not the ordinary case, an embezzlement loss is not deductible only in the year "occurring". If this case is not out of the ordinary, we cannot conceive of what would be regarded by the Government as the extraordinary case. When the "occurring" year is unknown, the case is not ordinary.

The facts in the present case are similar to those involved in the *Boston Consolidated Gas* case and the cases which follow it, and are readily distinguishable from the cases relied on by the Government. The findings of fact show that the taxpayer first discovered

this loss in 1945; that, without fault on the part of the taxpayer, the particular year or years in which the acts of embezzlement took place could not be ascertained; and that it was determined in 1945 that the taxpayer had no enforceable claim for recovery of the missing funds. We respectfully submit, therefore, that this case falls outside the "ordinary" rule and that, under the precedents in point and the applicable Regulations, the taxpayer is entitled to deduct the loss in 1945, the year of discovery.

II. A Proper Construction of the Statute Permits the Deduction of an Embezzlement Loss in the Year of Discovery When the Year of Actual Taking Is Unknown.

The Government admits (p. 18) that the present case is indistinguishable from the *Boston Consolidated Gas* case. The gist of its argument is that the decision of the Court of Appeals for the First Circuit, while equitable, is contrary to the language of the statute, and to the principle that statutes resulting in oppressive conditions can be altered only by Congress and not by the courts.

Section 23(f) provides that in computing the net income of corporations there shall be deducted "* * *, losses *sustained* during the taxable year and not compensated for by insurance or otherwise." (Italics ours). The Government assumes that this provision reads "losses occurring during the taxable year," and then argues that the Court of Appeals for the First Circuit, in order to avoid an oppressive and harsh result, judicially modified the "plain" words of the statute by

allowing a deduction in a year other than the year of occurrence of the loss. It is true that the decision of the First Circuit avoided a harsh and oppressive result, but it does not follow that the decision is contrary to the language of the statute or to the general principles heretofore announced by this Court as guides to the time for the deduction of losses. Despite the Government's assumption to the contrary, embezzlement losses on facts such as those involved in the *Boston Consolidated Gas* case and the instant case, are not necessarily "sustained" in the year of taking within the meaning of the statute.

Section 214(a)(6) of the Revenue Act of 1921, 42 Stat. 227, 240, dealing with deductions by individuals, provided that certain losses, such as losses from theft, should be deducted as of the taxable year in which sustained unless, in order to clearly reflect the income, the loss should, in the opinion of the Commissioner, be accounted for as of a different period. The corresponding section for corporate taxpayers was section 234(a)(4), which contained a similar provision. In explaining the purpose of this provision, the report of the Senate Finance Committee (S. Rep. No. 275, 67th Cong., 1st sess., pp. 14-15, 1939-1 Cum. Bull. [Part 2] 181, 191) states:

> "* * * To permit *more elastic treatment* of such losses, *in the interests of justice to the taxpayer,* it is provided that certain losses shall not be deducted as of the taxable year in which sustained, if in the opinion of the Commissioner they should be accounted for as of a different period;" (Italics ours).

Argument.

In the Revenue Act of 1924 the provision permitting loss deductions to be taken for a year other than the one in which sustained, in order to reflect income clearly, was shifted to section 200(d) (what is now section 43 of the Internal Revenue Code) and was broadened to cover all deductions and credits rather than just losses. H. Rep. No. 179, 68th Cong., 1st sess., pp. 10-11; 1939-1 Cum. Bull. [Part 2] 241, 249. In addition, the phrase "in the opinion of the Commissioner" was omitted from the provision in the Revenue Act of 1924 and has not appeared in the corresponding provision of any subsequent Revenue Act.

Although the particular provision explained in the above quotation of the Senate Finance Committee does not appear in section 23(f), the present counterpart of section 234(a)(4) of the 1921 Act, the quotation is nevertheless appropriate to show a basic intention of Congress to enact statutory provisions covering the time for deduction of losses that would be sufficiently elastic to provide a fair and just result. If the taxpayer is not permitted to deduct this embezzlement loss in 1945, it will never obtain a deduction for such loss—a most inequitable result. It should, therefore, be permitted to treat the loss as "sustained" in the year of discovery, unless the plain words of the statute *require* the deduction only in the year or years of occurrence of the acts of embezzlement.

The statute permits the deduction of losses *sustained* during the taxable year, but nowhere does it define what is meant by the word "sustained". That this can mean something different from losses *occurring* during the taxable year is perhaps most clearly demon-

strated by a further quotation from the report of the Senate Finance Committee cited above. In explaining the purpose of section 214(a)(6) of the 1921 Act, the report states (S. Rep. No. 275, 67th Cong., 1st sess., pp. 14-15, 1939-1 Cum. Bull. [Part 2] 181, 191):

> "* * * losses *occurring* in one year are frequently not *determined or sustained* until another year, depending upon court decision or the clearing up of uncertainty. * * *" (Italics ours).

The above quotation shows that the Senate Finance Committee recognized that a loss is not always "sustained" in the year of occurrence. The Committee used the word "sustained" as having a meaning similar to "determined", and used both those words as meaning something different from "occurring".

It is apparent that the statutory expression "losses sustained during the taxable year" is not so fixed and inflexible a concept as to be incapable of judicial interpretation, and that the Government's position, that the *Boston Consolidated Gas* decision and the decision of the District Court in this case are in disregard of the plain language of the statute, is unwarranted. In construing this statutory expression, this Court has on several occasions announced that the requirement that losses be deducted in the year in which they are sustained calls for a *practical,* not a legal, test:

In *Lucas v. American Code Co.,* 280 U. S. 445 (1930), a taxpayer breached a contract in 1919, lost a jury verdict in 1922, lost on appeal in 1923, and paid the judgment in 1923. It claimed the loss for 1919 on the theory that "all the facts which gave rise to the liability were fixed in that year", but this Court held that the loss was

not "as a matter of law or of undeniable fact, sustained in 1919. Nor did the Company so regard it" (p. 452). That language is most appropriate in the case at bar; the taxpayer could not "regard" the embezzlement as a loss before 1945 because it did not know about it. And Your Honors held (p. 449):

> "The general requirement that losses be deducted in the year in which they are sustained calls for a practical, not a legal test."

In *Burnet v. Huff*, 288 U. S. 156 (1933), another decision dealing with the interpretation of the statutory requirement that losses be deducted in the year in which sustained, this Court held (pp. 160-161):

> "And whether a taxpayer will actually sustain a loss through embezzlement of trust funds of which he is trustee will depend upon a variety of circumstances. If there is liability on his part for the misappropriation, it does not create a certainty of loss, as the defalcation may be made good by the one who caused it, or the liability of the taxpayer may be enforced only to a limited extent or not at all. The requirement that losses be deducted in the year in which they are sustained calls for a practical test."

And in *Boehm v. Commissioner*, 326 U. S. 287 (1945), a case dealing with the question of the time for deduction of a loss resulting from stock becoming worthless, this Court, after citing with approval *Lucas v. American Code Co., supra*, stated (p. 293):

> "The standard for determining the year for deduction of a loss is thus a flexible, practical one, varying according to the circumstances of each case."

Such statements by this Court not only demonstrate that the statutory language is such as to require judicial interpretation, but also show that the statute provides a degree of flexibility, so that the year in which the loss is sustained may be determined in the light of the facts of the particular case and a practical result may be thereby achieved. Certainly the Court of Appeals in the *Boston Consolidated Gas* case applied a "practical" test in deciding that a loss need not be deducted in the year of the happening of an event, if it is not known when that event happened. This is not judicial legislation, but rather an entirely appropriate construction of a statutory provision intended to be flexible.

A construction of the statute permitting the deduction of an embezzlement loss in the year of discovery, where the year of actual taking is unknown, is required by another principle, enunciated in the *Boehm* case, 326 U.S. 287, 291, that losses actually sustained during a taxable period must be fixed by identifiable events. To the same effect is the provision of Treasury Regulations 111, Section 29.23(e)-1, that losses "must be . . . fixed by identifiable events." On facts such as were involved in the *Boston Consolidated Gas* case and are involved here, the loss cannot be regarded as sustained, within the meaning of the statute, in any year prior to the year of discovery, since there is no "identifiable event" to fix the loss in any of the prior years.

Such a construction of the statute is in accord with the basic principle, applicable to items of deduction generally, reiterated by this Court in *Dixie Pine Products Co. v. Commissioner*, 320 U.S. 516 (1944), that liabilities

that remain uncertain or unknown during the taxable year cannot be accrued as deductions for such year, but are deductible only when the liability has become fixed and definite and reasonably ascertainable in amount. If, as in *Dixie Pine*, a taxpayer who contests a tax may not accrue his liability therefor so long as it remains uncertain whether he will ever have to pay it, the victim of an embezzlement loss should not be required to claim a deduction for his loss while it is not only uncertain what the ultimate loss will be, if any, but also while the very fact that there has been an embezzlement is unknown. Such a loss is neither fixed nor definite nor reasonably ascertainable in amount.

III. The Logical Corollary of the Rule That an Embezzlement Creates a Debtor-Creditor Relationship Is That the Victim of the Embezzlement Does Not Sustain a Loss Until the Embezzlement Is Discovered and Its Amount Determined.

The Government relies on numerous cases in the lower courts which set forth an "ordinary rule" that embezzlement losses are deductible in the year the money is taken (p. 15). We have already considered the point that this case, since the year of the taking is unknown, is the extraordinary rather than the ordinary case. But we go further: we point out that every one of the cases relied upon by the Government was decided prior to the decision of this Court in *Commissioner v. Wilcox*, 327 U.S. 404 (1945). The *Wilcox* case held that an embezzler realizes no taxable income from the embezzlement because at the time of the taking he automatically becomes

obligated to repay the money to his victim. In view of this decision, we submit that these older cases of the lower courts setting forth the so-called ordinary rule can no longer be applied to a case where the embezzlement is not discovered and the amount ascertained until a subsequent year, whether or not the exact year in which the taking occurred subsequently becomes known.

The reasoning of these older cases is made clear in *Peterson Linotyping Co.*, 10 B.T.A. 542 (1928), where the Board of Tax Appeals held that an embezzlement loss is deductible only when the money was taken because (p. 544)

> "We think that the conclusion reached in that case is sound and applicable here and that the embezzlement by Budde from the Regan Printing House, Inc., constituted a loss to the company but did not create the relation of debtor and creditor."

And this is the basis of the cases cited by the Government (p. 15).

But in *Commissioner v. Wilcox* this Court reasoned (pp. 408-409):

> "Under Nevada law the crime of embezzlement was complete whenever an appropriation was made; the employer was entitled to replevy the money as soon as it was appropriated or to have it summarily restored by a magistrate. The employer, moreover, at all times held the taxpayer liable to return the full amount. *The debtor-creditor relationship was definite and unconditional.* All right, title and interest in the money rested with the employer." (Italics ours).

The Pennsylvania law is not different here from the Nevada law. 10 *Standard Penna. Practice* 601.

It is true, as the *Wilcox* case said (p. 409) and as the Government's brief points out (p. 17), that generally there need not be a relationship between income to one taxpayer and a deduction to another. Nevertheless, the reasoning underlying the decision that the embezzler did not realize taxable income was that he was at all times under an unqualified duty and obligation to repay the money and that, therefore, a definite and unconditional debtor-creditor relationship had been established. In view of this reasoning, a rule of the lower courts based on the premise that embezzlement does "not create the relation of debtor and creditor" cannot stand.

Since a lender sustains no loss at the time he makes a loan, the logical corollary of this Court's reasoning in the *Wilcox* case is that the victim of an embezzlement does not "sustain" a loss at the time of the embezzlement, but only when the embezzlement has been discovered and it is determined what portion of the embezzled funds is not recoverable. In his concurring opinion in the *Boston Consolidated Gas* case, decided prior to this Court's decision in the *Wilcox* case, Judge Magruder reasoned that if a wrongdoer makes no gain from his embezzlement (as had been held in *McKnight v. Commissioner*, 127 F.2d 572 (5th Cir., 1942), which was later approved in the *Wilcox* case), then logically the person whose money is taken does not "sustain" a loss at the time of the embezzlement. And, subsequent to the *Wilcox* case, the Tax Court has held that the *Wilcox* case requires the conclusion that an embezzle-

ment loss is deductible when discovered and the amount determined. *Gwinn Brothers & Co.*, 7 T.C. 320, 325 (1946):

> "In addition, under the *Wilcox* case, *supra* (though the question there was to income, the question of debtor-creditor relation was pertinently considered), it seems clear that the embezzlement made the embezzler debtor to the petitioner — and it is stipulated that there was discovery, determination and worthlessness, and charge-off in 1935."

We do not imply that under the *Wilcox* case every embezzlement loss automatically becomes deductible as a bad debt under section 23(k) of the Internal Revenue Code. That section specifically deals with debts becoming worthless and is narrower in scope than sections 23(e) and 23(f) which deal with losses generally. Since a debt in the usual sense results from a voluntary loan which the borrower expressly agrees to repay, we think it entirely appropriate to limit the scope of section 23(k) to bad debts arising from a voluntary debtor-creditor relationship and to embezzlement cases where the embezzler upon discovery agrees to make restitution but becomes unable to keep his promise. Nevertheless the voluntary debtor-creditor relationship of the typical loan and the involuntary debtor-creditor relationship discussed in the *Wilcox* case are sufficiently parallel to call for an application of similar principles. The creditor is not regarded as suffering his bad debt loss at the time he makes the loan; therefore, the victim of an embezzlement should not be regarded as sustaining a loss at the time his funds are surreptitiously taken, but only when the fact of the loss becomes fixed and definite and the amount becomes reasonably determinable.

In any event, even if the embezzlement victim is regarded as having "sustained", in a technical sense, his loss in the year of taking, the reasoning of the *Wilcox* case, coupled with the express terms of the statute, permits the deduction of the loss when the amount recoverable is determined. Congress intended the statutory provision governing the time for the deduction of losses to have some degree of flexibility in order that practical results might be reached, as is shown by the language of the statute itself which provides that taxpayers may deduct losses sustained during the taxable year *not compensated for by insurance or otherwise.* An event resulting in a loss may occur in one year, but the extent, if any, to which the loss is compensated for may not be determinable until a subsequent year. The statute therefore indicates that Congress recognized that the economic impact of the loss is not suffered by the taxpayer until the year in which it is determined whether or not the loss is to be reimbursed by an insurer or other person. As shown by *Piedmont Grocery Co. v. United States,* 66 C. Cls. 468 (1928), *cert. den.* 280 U. S. 554 (1930), relied on by the Government (p. 16), an embezzlement loss is not deductible if the employee is bonded and recovery may be had against the bonding company, even though the recovery may be in a later year.

Since the *Wilcox* case holds that the embezzlement gives rise to a concurrent obligation on the part of the embezzler to repay his victim, then even if the loss be regarded as technically "sustained" in the year of the taking, the phrase "not compensated for by insurance or otherwise" is certainly applicable, and the language of the statute permits the deduction of the loss in the

year when it is determined how much of the embezzled funds are recoverable.

IV. In Any Event, Where the Year of Actual Embezzlement Is Unknown, an Embezzlement Loss Is Deductible in the Year of Discovery in Order to Clearly Reflect the Income of the Taxpayer.

The legislative history of Section 43 of the Internal Revenue Code and of its predecessor provisions contained in earlier Revenue Acts establishes that a loss is to be allowed as a deduction in the year such allowance is necessary to clearly reflect income, regardless of when the loss was "sustained".

Section 214(a)(6) of the Revenue Act of 1918, 40 Stat. 1057, 1066, allowed as a deduction "losses sustained during the taxable year". In the Revenue Act of 1921, Congress added the following sentence to Section 214(a)(6), 42 Stat. 227, 240:

> "Losses allowed under paragraphs (4), (5) and (6) of this subdivision shall be deducted as of the taxable year in which sustained unless, in order to clearly reflect the income, the loss should, in the opinion of the Commissioner, be accounted for as of a different period."

Section 234(a)(4), applicable to corporate taxpayers, contained a similar provision. The purpose of this provision was explained by the Senate Committee on Finance (S. Rep. No. 275, 67th Cong., 1st sess., pp. 14-15; 1939-1 Cum. Bull. [Part 2] p. 191), which said:

> ". . . losses occurring in one year are frequently not determined or sustained until another year, de-

pending upon court decision or the clearing up of uncertainty. To permit more elastic treatment of such losses, in the interests of justice to the taxpayer, it is provided that *certain losses shall not be deducted as of the taxable year in which sustained,* if in the opinion of the Commissioner they should be accounted for as of a different period; . . ." (Italics ours)

The Commissioner made a corresponding change in his regulations. Article 111 of Regulations 45 under the Revenue Act of 1918 had provided:

"A loss from theft or embezzlement occurring in one year and discovered in another is deductible only for the year of its occurrence."

But in Article 111 of Regulations 62 cross reference was made to Article 146, where the Commissioner stated:

"In exceptional circumstances, however, in order to avoid injustice to the taxpayer and to more clearly reflect his income, the Commissioner may permit a loss to be accounted for as of a year other than the one in which sustained. For example, an embezzlement or a shipwreck may occur in 1921 but not become known until 1922 and in such a case income may be more clearly reflected by accounting for the loss as of 1922 rather than of 1921."

Were this case to be decided under the Revenue Act of 1921, therefore, the taxpayer would clearly be right.

Section 214(a)(6) of the Revenue Act of 1924, 43 Stat. 253, omitted the sentence which had appeared in the Revenue Act of 1921 providing for accounting "as of a different period". But the sentence of section 214(a)(6) was not omitted, as the Government asserts

(p. 26), because of a "more mature appreciation" of a "concept of a clear reflection of income". On the contrary, the Ways and Means Committee in its report, H. Rep. No. 179, 68th Cong., 1st sess., p. 10, 1939-1 Cum. Bull. [Part 2] 249, stated:

> "The Revenue Act of 1921 in sections 214(a)(6) and 234(a)(4) authorizes the Commissioner to allow the deduction of losses in a year other than that in which sustained when, in his opinion, it is necessary to clearly reflect the income. The proposed bill extends that theory to all deductions and credits."

This extension of the principle of accounting "as of a different period" was accomplished by new Section 200(d), which declared:

> "The deductions and credits provided for in this title shall be taken for the taxable year in which 'paid or accrued' or 'paid or incurred', dependent upon the method of accounting upon the basis of which the net income is computed under section 212 or 232, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period."

And Regulations 65 contained a new provision, Article 1523, which copied the language of Section 200(d).

The first sentence of Section 43 of the Internal Revenue Code, in force in 1945, is the same as section 200(d) of the Revenue Act of 1924. The principle of the Revenue Act of 1921 that "losses shall not be deducted as of the taxable year in which sustained", with its extension "to all deductions and credits" by the Revenue Act of 1924, is therefore still in effect. And the provision of the

Revenue Act of 1921 giving weight to "the opinion of the Commissioner" was omitted in the Revenue Act of 1924 and subsequent acts so that what the Government calls the Commissioner's "vague discretion" (pp. 23-24) no longer troubles us. The question is no longer one of his opinion but of fact and law.

The reliance of the Government (pp. 21-28) on *Security Flour Mills Co. v. Commissioner*, 321 U. S. 281 (1944), is, we respectfully submit, misplaced. It was there held (pp. 285-286) that the qualifying clause, "unless in order to clearly reflect the income the deductions or credits should be taken as of a different period":

> ". . . was not intended to upset the well-understood and consistently applied doctrine that cash receipts or matured accounts due on the one hand, and cash payments or accrued definite obligations on the other, should not be taken out of the annual accounting system and, for the benefit of the Government or the taxpayer, treated on a basis which is neither a cash basis nor an accrual basis, because so to do would, in a given instance, work a supposedly more equitable result to the Government or to the taxpayer."

The decision was based on the analysis made by Mr. Justice Roberts of the legislative history of the Revenue Act of 1924, from which he concluded (p. 285):

> "From these reports it is clear that the purpose of inserting the qualifying clause was to take care of fixed liabilities payable in fixed installments over a series of years."

That conclusion, with respect to deductible expenses such as prepaid interest or rent or the type of expense

deduction involved in the *Security Flour Mills* case, finds ample support in the committee reports relative to the 1924 Act quoted in the opinion. However, neither the *Security Flour Mills* decision nor the committee report quotations relied on were dealing with the deductibility of *losses* under the qualifying clause.

As recognized in the majority opinion of Mr. Justice Roberts and as shown in the quotation from the committee reports, the insertion of the above-mentioned qualifying clause in the 1924 Act was made to *extend* to other items of deduction and credit an existing provision, contained in sections 214(a)(6) and 234(a)(4) of the Revenue Act of 1921, permitting the deduction of losses in a year other than that in which sustained when that was necessary to reflect income clearly. When, in enacting the 1924 Act, Congress omitted the earlier provision from sections 214(a)(6) and 234(a)(4) and inserted instead the broader qualifying clause in section 200(d), Congress meant to incorporate, not eliminate, the earlier provision with respect to losses.

Thus, although the qualifying clause in its present form was first added to the statute in section 200(d) of the Revenue Act of 1924, it is the 1921 Act, not the 1924 Act, that is the father of the basic concept of the present section 43 of the Internal Revenue Code. The 1921 Act, as we have shown, was concerned exclusively with "losses" and the committee reports and Regulations under that Act made it clear that Congress intended that losses occurring in one year, but determined in another, need not be deducted as of the taxable year in which they occurred. The Congressional purpose in changing this statutory provision and enacting the

broader qualifying clause in section 200(d) of the 1924 Act was as stated by Mr. Justice Roberts, namely, to take care of *additional* situations such as the one of fixed liabilities payable over a series of years. But the situation with respect to "losses" had already been taken care of in the 1921 Act, and the 1924 Act was designed to *extend that theory*, not to restrict it. When the Government says "it is to be doubted" whether section 43 applies to losses (p. 29), it is ignoring the legislative history and, as it admits (p. 18), it is contradicted by the only judicial decision.

We urge that the decision of this Court in the *Security Flour Mills* case (that the 1924 Act's extension of the losses "theory" of the 1921 Act to other deductions and credits was meant to cover only limited situations such as fixed liabilities payable in fixed installments over a series of years) is no bar to a recognition that the legislative history concerning this extension manifests Congressional intention to preserve the earlier provision *as to losses* in full force and effect. That earlier provision as to losses was not limited to losses payable in fixed installments over a series of years; such situations do not exist with respect to losses, and to impose any such limitation with respect to deductions for losses would be to say that the qualifying clause has no application at all to losses, but only to expenses. Indeed, the legislative intent, as the Commissioner's Regulations once declared, was to permit embezzlement or shipwreck losses which occurred in one year and became known in another to be deducted in the year they had "become known". Reg. 62, Art. 146.

In the case at bar, if the taxpayer knew that the money had been embezzled say in 1943 or 1944, it could deduct its loss in that year. It does not, however, know when the money was embezzled, although it used diligent efforts to try to discover the year. If it does not get the deduction in 1945, the year of discovery of the loss, it will not get the deduction in any year whatever. Its income for the years involved would thus not be clearly reflected, but would be distorted contrary to the express will of Congress.

Conclusion.

The decision of the District Court is in accordance with the precedents in point and the applicable Treasury Regulations. It is not in disregard of the statutory language but, rather, is required by a proper construction of the statute and by the basic principles governing the time for deduction of losses and other items. Further, the decision is in accordance with the reasoning of this Court in *Commissioner v. Wilcox;* and, in any event, is required by a proper application of section 43 of the Internal Revenue Code to the facts of this case. Accordingly, the question certified to this Court by the Court below should be answered in the affirmative and the judgment of the District Court affirmed.

Respectfully submitted,

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